



Committee of Sponsoring Organizations of the Treadway Commission

## **Internal Control—Integrated Framework**

### **Illustrative Tools for Assessing Effectiveness of a System of Internal Control**

**September 2012**

# Exposure Period Version

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# Preface

This project was commissioned by COSO, which is dedicated to providing thought leadership through the development of comprehensive frameworks and guidance on internal control, enterprise risk management, and fraud deterrence designed to improve organizational performance and oversight and to reduce the extent of fraud in organizations. COSO is a private sector initiative, jointly sponsored and funded by:

- American Accounting Association (AAA)
- American Institute of Certified Public Accountants (AICPA)
- Financial Executives International (FEI)
- Institute of Management Accountants (IMA)
- The Institute of Internal Auditors (IIA)

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# Introduction

1 This publication, *Internal Control—Integrated Framework: Illustrative Tools for Assessing Effectiveness of a System of Internal Control (Illustrative Tools)*, is intended to assist management of entities using the COSO *Internal Control—Integrated Framework: Framework and Appendices (Framework and Appendices)* when assessing effectiveness of a system of internal control based on the requirements set forth in the Framework. More specifically, Illustrative Tools can help management assess whether:

- Each of the five components and relevant principles are present and functioning; and
- The five components are operating together in an integrated manner.

2 For complete details, please refer to the *Framework and Appendices*, especially Chapter 3, Effective Internal Control, when using *Illustrative Tools*.

This publication is organized into sections: Introduction, Templates and Scenarios:

- The templates can be used to assess the effectiveness of a system of internal control and to document such assessment.
- The scenarios illustrate how the templates can be used to support an assessment of effectiveness of a system of internal control.

3 The templates and scenarios focus on evaluating components and relevant principles, not the underlying controls (e.g., transaction-level control activities) that effect principles. These tools are not designed with the intent to satisfy any regulatory, jurisdictional, or standard-setting requirements for evaluating the severity of internal control deficiencies associated with a particular objective, such as external financial reporting. As noted in the Framework, regulators, standard-setting bodies, and other relevant third parties may establish criteria for evaluating the severity and corresponding classification and reporting of deficiencies relating to external reporting objectives, operations, and compliance objectives.

## Templates

4 The templates included here are designed to present only a summary of the assessment results. They are not an integral part of the Framework, and they may not address all matters that need to be considered in assessing a system of internal control for a specified objective. Further, they do not represent a preferred method of conducting and documenting an assessment. Their purpose is limited to illustrating one possible assessment process based on the requirements set forth in the Framework. Accordingly, the templates do not illustrate management's selection of controls to effect principles or the determination of scope, nature, timing, and extent of testing such controls embedded within each component. The facts and circumstances relevant to an assessment will vary among different categories of objectives and among different entities and industries; therefore, the practical adoption and use of these tools will also vary.

## Form and Use

- 5 As the Framework applies to any type of entity, including large and small public, private, governmental and not-for-profit, so do the templates presented in this publication. Management planning to use these templates can modify them to reflect the facts (e.g., specified objectives and sub-objectives, scope of application, organizational structure) and assessment processes for their entity. For example,
- An entity with a complex organizational structure can modify or supplement the templates appropriately, as illustrated in Scenario E: “How are The Assessments of Multiple Locations Combined?”.
  - A smaller entity can simplify the templates to reflect a less complex organizational structure and to acknowledge a less-formal, less-structured system of internal control; for instance a system that reflects more direct and continuous communications about internal control among the CEO, senior managers, and other personnel.
  - An entity may use technology to maintain a consolidated summary of deficiencies that is referenced by all the templates rather than having summaries included in each template.
- 6 Organizations may leverage the templates to develop or configure automated solutions to support their separate and/or ongoing evaluations and overall assessment process. Automated solutions can provide relevant information through system-generated reports and dashboards, which in turn may be used by various stakeholders such as the board of directors<sup>1</sup>, management, auditors, owners, and control and compliance management. Management would consider the outputs of the automated solutions to support its overall assessment of a system of internal control, but management would generally exercise judgment about its overall assessment outside of its automated solution.
- 7 An organization can customize the level and amount of detail included in the templates, as they may deem necessary. For example, consider Principle 2 within the Control Environment, *Exercises Oversight Responsibility*. The controls that effect this principle likely occur at the entity level, and management may determine that the documentation relating to these controls may not need to be extensive to support the evaluation. Accordingly, in this example, these templates can be used to fully document and assess whether this principle is present and functioning. In contrast, controls to effect Principle 10 within Control Activities, *Selects and Develops Control Activities*, are likely deployed throughout the organization and, accordingly, the documentation relating to these controls would be expected to be more extensive and detailed. Documentation of management’s evaluation of whether this principle is present and functioning would likely require additional templates, such as detailed risk and control matrices, not set forth in *Illustrative Tools*.

<sup>1</sup> As in the Framework, this publication uses the term “board of directors,” which encompasses the governing body, including board, board of trustees, general partners, owner, or supervisory board.

- 8 In summary, management may use these templates in several important ways:
- To support the assessment of whether all five components of a system of internal control are operating together in an integrated manner.
  - To support the determination of whether components and relevant principles are present and functioning.
  - To support the assessment of whether the system of internal control is effective relating to one category of objectives, such as reporting, or more than one category.
  - To document management's overall assessment relating to the effectiveness of a system of internal control at the entity and subunit levels, considering components and relevant principles.
  - To document internal control deficiencies identified during the assessment process.
- 9 If the templates are used as suggested, they offer the following benefits:
- They provide a logical structure for management to analyze and document the organization's assessment of effectiveness of internal control, including the presence and functioning of components and principles as set forth in the Framework using the points of focus for assistance.
  - They assist management in developing a process for identifying and evaluating internal control deficiencies within components and relevant principles relating to the assessment of effectiveness of internal control.

## Organization

- 10 The templates are organized to support a top-down, risk-based assessment approach. Four different templates are included.<sup>2</sup>
- *Overall Assessment*—Summarizes management's determination of whether all five components are present, functioning and operating together in an integrated manner, including the severity of internal control deficiencies or combination of internal control deficiencies when considered collectively across the components.
  - *Components*—Summarizes management's determination of whether each component, including its associated relevant principles, is present and functioning. Internal control deficiencies relating to each principle are listed and the severity of each deficiency is assessed considering whether it is compensated<sup>3</sup> for by controls that effect other principles in the component.

<sup>2</sup> For illustrative purposes the templates are shown as separate documents. In practice, an organization would likely use technology to link these templates to reduce redundant information; information common to more than one template would then automatically be populated across the templates. For example, an organization will likely use technology to maintain a consolidated summary of internal control deficiencies that is referenced by all the templates rather than having summaries included in each template.

<sup>3</sup> This publication broadly uses the term compensating controls as defined by the Securities Exchange Commission in the United States, "Compensating controls are controls that serve to accomplish the objective of another control that did not function properly, helping to reduce risk to an acceptable level."

- *Principles*—Summarizes management’s determination of whether each relevant principle is present and functioning<sup>4</sup>. Points of focus are provided to assist management in this determination. Management, in its judgment, identifies and considers suitable and relevant points of focus, including those presented in the Framework, that reflect the entity’s industry, operating, and regulatory environments. Thus, the templates include the points of focus set forth in the Framework as a starting point, which can be modified as appropriate. These templates also summarize any identified internal control deficiencies along with a preliminary determination of the severity of the internal control deficiencies. The determination of severity is preliminary pending the consideration of any compensating controls that effect the other principles within the component.
- *Summary of Internal Control Deficiencies*—Provides a log of all identified internal control deficiencies that can be leveraged in the evaluation of components and principles, and facilitate the combination of internal control deficiencies.

11 The diagram on the right page shows the relationship between each of the templates and the expected flow of key information (i.e., evaluation summaries and internal control deficiencies). While shown here as a serial process, in practice, it is likely to be iterative.

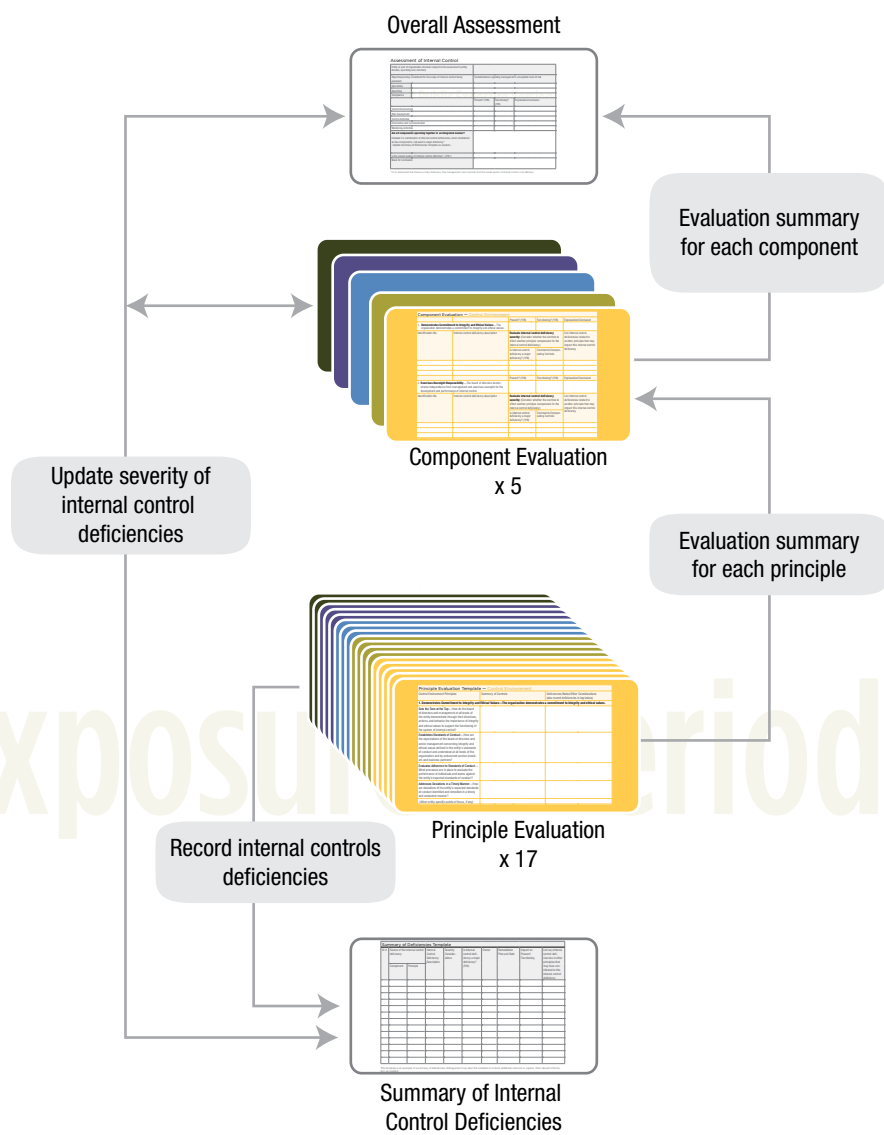
## Scenarios

12 The scenarios present several practical examples of how the templates can be used to support an assessment of effectiveness of a system of internal control based on the requirements set forth in the Framework. Each scenario is designed to illustrate a particular aspect, or set of related aspects, of the assessment process, and each consists of two parts:

- Background material to provide context for the scenario (e.g., company background, relevant paragraphs of the Framework, summary of key points)
- Completed templates

13 The scenarios highlight important considerations in performing an assessment. They do not present a comprehensive view of how an organization would perform the overall assessment of internal control as they do not present all possible aspects of the assessment process. The templates that accompany the scenarios are intended to serve as examples and should not be viewed as comprehensive documentation depicting all relevant controls and assessments. Management should consider the Framework only for designing and implementing a system of internal control. The content in the templates is meant to enable readers to focus on the concepts illustrated in the scenarios. It does not necessarily show an acceptable level of documentation set by management or established by laws, regulations and standards. Also, only those templates relevant to the objective of the scenario are included.

<sup>4</sup> All principles set forth in the Framework are included in the templates. There may be a rare industry, operating, or regulatory situation in which management has determined that a particular principle is not relevant to the associated component.



- 14** The severity of internal control deficiencies contained in the scenarios is included to illustrate considerations in performing an assessment. Determining the severity of a deficiency is a highly judgmental process that depends on specific facts and circumstances and that is often defined by criteria established by regulators, standard-setting bodies, and other relevant third parties.
- 15** Each scenario is pertinent to any type of entity, although specific facts and circumstances may not apply. Each scenario is accompanied by a brief summary of any differences that are likely to exist between the scenario and other types of entities.

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# Templates

# 1. Overall Assessment of Internal Control Template

Assessment of Internal Control			
Entity or part of organization structure subject to the assessment (entity, division, operating unit, function)			
Objective(s) being considered for the scope of internal control being assessed		Considerations regarding management's acceptable level of risk	
Operations			
Reporting			
Compliance			
		Present? (Y/N)	Functioning? (Y/N)
Control Environment			
Risk Assessment			
Control Activities			
Information and Communication			
Monitoring Activities			
<b>Are all components operating together in an integrated manner?</b> Evaluate if a combination of internal control deficiencies, when considered across components, represent a major deficiency.* <Update Summary of Deficiencies Template as needed>			
Is the overall system of internal control effective? <Y/N>*			
Basis for conclusion			

\* If it is determined that there is a major deficiency, then management must conclude that the overall system of internal control is not effective.

## 2. Component Evaluation Template

Component Evaluation — Control Environment				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
1. <b>Demonstrates Commitment to Integrity and Ethical Values</b> —The organization demonstrates a commitment to integrity and ethical values.				
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)  Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
			Comments/Compensating Controls	
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
2. <b>Exercises Oversight Responsibility</b> —The board of directors demonstrates independence from management and exercises oversight for the development and performance of internal control.				
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)  Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
			Comments/Compensating Controls	



Component Evaluation — Control Environment				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
5. <b>Enforces Accountability</b> —The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.				
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)  Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
			Comments/Compensating Controls	
		Explanation/Conclusion		
<b>Evaluate deficiencies across the component:*</b>  Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**				
Evaluate the component using judgment and based on the principles and the deficiencies.**		Yes/No	Explanation/Conclusion	
Is the component present?				
Is the component functioning?				

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

Component Evaluation — Risk Assessment				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
6. <b>Specifies Suitable Objectives</b> —The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.				
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.) Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
7. <b>Identifies and Analyzes Risks</b> —The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.				
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.) Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		

Component Evaluation — Risk Assessment				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
8. <b>Assesses Fraud Risk</b> —The organization considers the potential for fraud in assessing risks to the achievement of objectives.				
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.) Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		
9. <b>Identifies and Analyzes Significant Change</b> —The organization identifies and assesses changes that could significantly impact the system of internal control.				
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.) Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		

Component Evaluation — Risk Assessment		
	Explanation/Conclusion	
<b>Evaluate deficiencies across the component:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**		
Evaluate the component using judgment and based on the principles and the deficiencies.**	Yes/No	Explanation/Conclusion
Is the component present?		
Is the component functioning?		

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

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\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

Component Evaluation — Information and Communication				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
13. <b>Uses Relevant Information</b> —The organization obtains or generates and uses relevant, quality information to support the functioning of other components of internal control.				
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.) Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		
14. <b>Communicates Internally</b> —The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control.				
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.) Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		

Component Evaluation — Information and Communication				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
15. <b>Communicates Externally</b> —The organization communicates with external parties regarding matters affecting the functioning of other components of internal control.				
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
		Explanation/Conclusion		
<b>Evaluate deficiencies across the component:*</b>				
Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**				
Evaluate the component using judgment and based on the principles and the deficiencies.**		Yes/No	Explanation/Conclusion	
Is the component present?				
Is the component functioning?				

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

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Component Evaluation — Monitoring Activities		
	Explanation/Conclusion	
<b>Evaluate deficiencies across the component:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**		
Evaluate the component using judgment and based on the principles and the deficiencies.**	Yes/No	Explanation/Conclusion
Is the component present?		
Is the component functioning?		

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

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### 3. Principle Evaluation Templates

Principle Evaluation Template — <b>Control Environment</b>		
Control Environment Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>1. Demonstrates Commitment to Integrity and Ethical Values—The organization demonstrates a commitment to integrity and ethical values.</b>		
<b>Sets the Tone at the Top</b> —How do the board of directors and management at all levels of the entity demonstrate through their directives, actions, and behavior the importance of integrity and ethical values to support the functioning of the system of internal control?		
<b>Establishes Standards of Conduct</b> —How are the expectations of the board of directors and senior management concerning integrity and ethical values defined in the entity's standards of conduct and understood at all levels of the organization and by outsourced service providers and business partners?		
<b>Evaluates Adherence to Standards of Conduct</b> —What processes are in place to evaluate the performance of individuals and teams against the entity's expected standards of conduct?		
<b>Addresses Deviations in a Timely Manner</b> —How are deviations of the entity's expected standards of conduct identified and remedied in a timely and consistent manner?		
(Other entity specific points of focus, if any)		

### Principle Evaluation Template — Control Environment

Deficiencies Applicable to the Principle						
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		<Explanation>				
Evaluate the principle using judgment.**		Y/N		Explanation/Conclusion		
Is the principle present?						
Is the principle functioning?						

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.



Principle Evaluation Template — Control Environment		
Control Environment Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>2.Exercises Oversight Responsibility—The board of directors demonstrates independence from management and exercises oversight for the development and performance of internal control.</b>		
Establishes Oversight Responsibilities—How does the board of directors identify and accept its oversight responsibilities in relation to established requirements and expectations?		
Applies Relevant Expertise—How does the board of directors define, maintain, and periodically evaluate the skills and expertise needed among its members to enable them to ask probing questions of senior management and take commensurate actions?		
Operates Independently—Does the board of directors have sufficient members who are independent from management and how do they demonstrate they are objective in evaluations and decision making?		
Provides Oversight for the System of Internal Control—How does the board of directors retain oversight responsibility for management's development and performance of internal control (see areas below)?		
Control Environment—Establishing integrity and ethical values, oversight structures, authority and responsibility, expectations of competence, and accountability to the board.		

## Principle Evaluation Template — Control Environment

**Risk Assessment**—Overseeing management’s assessment of risks to the achievement of objectives, including the potential impact of significant changes, fraud, and management override of internal control.

**Control Activities**—Providing oversight to senior management in the development and performance of control activities.

**Information and Communication**—Analyzing and discussing information relating to the entity’s achievement of objectives.

**Monitoring Activities**—Assessing and overseeing the nature and scope of monitoring activities and the management’s evaluation and remediation of deficiencies.

(Other entity specific points of focus, if any)

### Deficiencies Applicable to the Principle

Identification No.	Internal control deficiency description	Possible Impact on Principle		<b>Evaluate preliminary deficiency severity:</b> (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	

## Principle Evaluation Template — Control Environment

<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>	<Explanation>	
Evaluate the principle using judgment.**	Y/N	Explanation/Conclusion
Is the principle present?		
Is the principle functioning?		

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

Principle Evaluation Template — **Control Environment**

Control Environment Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>3. Establishes Structure, Authority, and Responsibility—Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.</b>		
Considers All Structures of the Entity—How do management and the board of directors consider the multiple structures used (including operating units, legal entities, geographic distribution, and outsourced service providers) to support the achievement of objectives?		
Establishes Reporting Lines—How does management design and evaluate lines of reporting for each entity structure to enable execution of authorities and responsibilities and flow of information to manage the activities of the entity?		
Defines, Assigns, and Limits Authorities and Responsibilities—How does management and the board of directors delegate authority, define responsibilities, use appropriate process and technology to assign responsibilities and segregate duties as necessary at the various levels of the organization?		
<i>Board of Directors</i> —Retains authority over significant decisions and reviews management's assignments and limitations of authorities and responsibilities		
<i>Senior Management</i> —Establishes directives, guidance, and control to enable management and other personnel to understand and carry out their internal control responsibilities.		
<i>Management</i> —Guides and facilitates the execution of senior management directives at entity and its subunits.		

## Principle Evaluation Template — Control Environment

<p><b>Personnel</b>—Understands the entity’s standard of conduct, assessed risks to objectives, and the related control activities at their respective levels of the entity, the expected information and communication flow, and monitoring activities relevant to their achievement of the objectives.</p>					
<p><b>Outsourced Service Providers</b>—Adheres to management’s definition of the scope of authority and responsibility for all non-employees engaged.</p>					
<p>(Other entity specific points of focus, if any)</p>					
<p>Deficiencies Applicable to the Principle</p>					
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)	List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls

### Principle Evaluation Template — Control Environment

**Evaluate deficiencies within the principle:\***

Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.\*\*

<Update Summary of Deficiencies Template as required>

<Explanation>

Evaluate the principle using judgment.\*\*

Y/N

Explanation/Conclusion

Is the principle present?

Is the principle functioning?

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

Principle Evaluation Template — Control Environment		
Control Environment Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>4. Demonstrates Commitment to Competence—The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.</b>		
Establishes Policies and Practices—How do the policies and practices reflect expectations of competence necessary to support the achievement of objectives?		
Evaluates Competence and Addresses Shortcomings—How do the board of directors and management evaluate competence across the organization and in outsourced service providers in relation to established policies and practices, and act as necessary to address shortcomings?		
Attracts, Develops, and Retains Individuals—How does the organization provide the mentoring and training needed to attract, develop, and retain sufficient and competent personnel and outsourced service providers to support the achievement of objectives?		
Plans and Prepares for Succession—How do senior management and the board of directors develop contingency plans for assignments of responsibility important for internal control?		
(Other entity specific points of focus, if any)		

## Principle Evaluation Template — Control Environment

## Deficiencies Applicable to the Principle

Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		<Explanation>				
Evaluate the principle using judgment.**		Y/N		Explanation/Conclusion		
Is the principle present?						
Is the principle functioning?						

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.



Principle Evaluation Template — Control Environment		
Control Environment Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>5. Enforces Accountability—The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.</b>		
Enforces Accountability through Structures, Authorities, and Responsibilities—How do management and the board of directors establish the mechanisms to communicate and hold individuals accountable for performance of internal control responsibilities across the organization and implement corrective action as necessary?		
Establishes Performance Measures, Incentives, and Rewards—How do management and the board of directors establish performance measures, incentives, and other rewards appropriate for responsibilities at all levels of the entity, reflecting appropriate dimensions of performance and expected standards of conduct, and considering the achievement of both short-term and longer-term objectives?		
Evaluates Performance Measures, Incentives, and Rewards for Ongoing Relevance—How do management and the board of directors align incentives and rewards with the fulfillment of internal control responsibilities in the achievement of objectives?		
Considers Excessive Pressures—How do management and the board of directors evaluate and adjust pressures associated with the achievement of objectives as they assign responsibilities, develop performance measures, and evaluate performance?		

## Principle Evaluation Template — Control Environment

Evaluates Performance and Rewards or Disciplines Individuals—How do management and the board of directors evaluate performance of internal control responsibilities, including adherence to standards of conduct and expected levels of competence and provide rewards or exercise disciplinary action as appropriate?

(Other entity specific points of focus, if any)

### Deficiencies Applicable to the Principle

Identification No.	Internal control deficiency description	Possible Impact on Principle	<b>Evaluate preliminary deficiency severity:</b> (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		<Explanation>			

Principle Evaluation Template — Control Environment		
Evaluate the principle using judgment.**	Y/N	Explanation/Conclusion
Is the principle present?		
Is the principle functioning?		

\* Note: Record deficiencies in Summary of Deficiencies Template.

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# Exposure Period Version

Principle Evaluation Template — Risk Assessment		
Risk Assessment Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>6. Specifies Suitable Objectives—The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.</b>		
Consider Points of Focus Relating to Operations Objectives		
<b>Reflects Management's Choices</b> —How do the operations objectives reflect management's choices about structure, industry considerations, and performance of the entity?		
<b>Considers Tolerances for Risk</b> —How does management consider the acceptable levels of variation relative to the achievement of operations objectives?		
<b>Includes Operations and Financial Performance Goals</b> —How does the organization reflect the desired level of operations and financial performance for the entity within operations objectives?		
<b>Forms Basis for Committing of Resources</b> —How does management use operations objectives as a basis for allocating resources needed to attain desired operations and financial performance?		
Consider Points of Focus Pertaining to External Financial Reporting		
<b>Complies with Applicable Accounting Standards</b> —How does management ensure that the financial reporting objectives are consistent with accounting principles suitable and available for that entity and that the accounting principles selected are appropriate in the circumstances?		

## Principle Evaluation Template — Risk Assessment

Considers Materiality—How does management consider materiality in financial statement presentation?		
Reflects Entity Activities—How does external reporting reflect the underlying transactions and events to show qualitative characteristics and assertions?		
Consider Points of Focus Pertaining to External Non-Financial Reporting		
Complies with Externally Established Standards and Frameworks—How does management establish objectives consistent with laws and regulations or standards and frameworks of recognized external organizations?		
Considers the Required Level of Precision—How does management reflect the required level of precision and accuracy suitable for user needs and as based on criteria established by third parties in non-financial reporting?		
Reflects Entity Activities—How does external reporting reflect the underlying transactions and events within a range of acceptable limits?		
Consider Points of Focus Pertaining to Internal Reporting Objectives (External and Internal)		
Reflects Management's Choices—How does internal reporting provide management with accurate and complete information regarding management's choices and information needed in managing the entity?		

## Principle Evaluation Template — Risk Assessment

<b>Considers the Required Level of Precision—</b> How does management reflect the required level of precision and accuracy suitable for user needs in non-financial reporting objectives and materiality within financial reporting objectives?						
<b>Reflects Entity Activities—</b> How does internal reporting reflect the underlying transactions and events within a range of acceptable limits?						
<b>Consider Points of Focus Pertaining to Compliance Objectives</b>						
<b>Reflects External Laws and Regulations—</b> How does the entity integrate into compliance objectives laws and regulations that establish minimum standards of conduct for the entity?						
<b>Considers Tolerances for Risk—</b> How does management consider the acceptable levels of variation relative to the achievement of compliance objectives?						
(Other entity specific points of focus, if any)						
<b>Deficiencies Applicable to the Principle</b>						
Identification No.	Internal control deficiency description	Possible Impact on Principle		<b>Evaluate preliminary deficiency severity:</b> (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	

Principle Evaluation Template — Risk Assessment		
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>	<Explanation>	
Evaluate the principle using judgment.**	Y/N	Explanation/Conclusion
Is the principle present?		
Is the principle functioning?		

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

Principle Evaluation Template — Risk Assessment		
Risk Assessment Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>7. Identifies and Analyzes Risk—The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.</b>		
Includes Entity, Subsidiary, Division, Operating Unit, and Functional Levels—How does the organization identify and assess risks at the entity, subsidiary, division, operating unit, and functional levels relevant to the achievement of objectives?		
Analyzes Internal and External Factors—How does management ensure that risk identification considers both internal and external factors and their impact on the achievement of objectives?		
Involves Appropriate Levels of Management—How does the organization put into place effective risk assessment mechanisms that involve appropriate levels of management?		
Estimates Significance of Risks Identified—How does management ensure that identified risks are analyzed through a process that includes estimating the potential significance of the risk?		
Determines How to Respond to Risks—How does management ensure that the risk assessment includes considering how the risk should be managed and whether to accept, avoid, reduce, or share the risk?		
(Other entity specific points of focus, if any)		



Principle Evaluation Template — Risk Assessment						
Deficiencies Applicable to the Principle						
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		<Explanation>				
Evaluate the principle using judgment.**		Y/N		Explanation/Conclusion		
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Principle Evaluation Template — Risk Assessment						
Risk Assessment Principles		Summary of Controls		Deficiencies/Notes/Other Considerations (also record deficiencies in log below)		
<b>8. Assess Fraud Risk—The organization considers the potential for fraud in assessing risks to the achievement of objectives.</b>						
Considers Various Types of Fraud—How does the assessment of fraud consider fraudulent reporting, possible loss of assets, and corruption resulting from the various ways that fraud and misconduct can occur?						
Assesses Incentive and Pressures—How does the assessment of fraud risk consider incentives and pressures?						
Assesses Opportunities—How does the assessment of fraud risk consider opportunities for unauthorized acquisition, use, or disposal of assets, altering of the entity's reporting records, or committing other inappropriate acts?						
Assesses Attitudes and Rationalizations—How does the assessment of fraud risk consider how management and other personnel might engage in or justify inappropriate actions?						
(Other entity specific points of focus, if any)						
Deficiencies Applicable to the Principle						
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)	List internal control deficiencies related to another principle that may impact this internal control deficiency	
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	

Principle Evaluation Template — Risk Assessment						
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		<Explanation>				
Evaluate the principle using judgment.**		Y/N	Explanation/Conclusion			
Is the principle present?						
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Principle Evaluation Template — Risk Assessment				
Risk Assessment Principles		Summary of Controls		Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>9. Identifies and Analyzes Significant Change—The organization identifies and assesses changes that could significantly impact the system of internal control.</b>				
Assesses Changes in the External Environment —How does the risk identification process consider changes to regulatory, economic, and the physical environment in which the entity operates?				
Assesses Changes in the Business Model— How does the organization consider the potential impacts of new business lines, dramatically altered compositions of existing business lines, acquired or divested business operations on the system of internal control, rapid growth, changing reliance on foreign geographies, and new technologies?				
Assesses Changes in Leadership—How does the organization consider changes in management and their respective attitudes and philosophies on the system of internal control?				
(Other entity specific points of focus, if any)				
Deficiencies Applicable to the Principle				
Identification No.	Internal control deficiency description	Possible Impact on Principle	<b>Evaluate preliminary deficiency severity:</b> (Consider whether other controls to effect this principle compensate for the internal control deficiency.)	List internal control deficiencies related to another principle that may impact this internal control deficiency

Principle Evaluation Template — Risk Assessment					
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Sever- ity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compen- sating Controls
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		<Explanation>			
Evaluate the principle using judgment.**		Y/N		Explanation/Conclusion	
Is the principle present?					
Is the principle functioning?					

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

Principle Evaluation Template — Control Activities		
Control Activities Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>10. Selects and Develops Control Activities—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.</b>		
Integrates with Risk Assessment—How do the control activities help ensure that responses that address and mitigate risks are carried out?		
Determines Relevant Business Processes—How does management determine which relevant business processes require control activities?		
Considers Entity-Specific Factors—How does management consider how the environment, complexity, nature, and scope of its operations, as well as the specific characteristics of its organization, affect the selection and development of control activities?		
Evaluates a Mix of Control Activity Types—How do the control activities include a range and variety of controls and a balance of approaches to mitigate risks, considering both manual and automated controls, and preventive and detective controls?		
Considers at What Level Activities Are Applied—How does management consider control activities at various levels in the entity?		
Addresses Segregation of Duties—How does management segregate incompatible duties, and where such segregation is not practical, does management select and develop alternative control activities?		
(Other entity specific points of focus, if any)		

Principle Evaluation Template — Control Activities						
Deficiencies Applicable to the Principle						
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		<Explanation>				
Evaluate the principle using judgment.**		Y/N		Explanation/Conclusion		
Is the principle present?						
Is the principle functioning?						

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

## Principle Evaluation Template — Control Activities

Control Activities Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>11. Selects and Develops General Controls over Technology—The organization selects and develops general control activities over technology to support the achievement of objectives.</b>		
Determines Dependency between the Use of Technology in Business Processes and Technology General Controls—How does management understand and determine the dependency and linkage between business processes, automated control activities, and technology general controls?		
Establishes Relevant Technology Infrastructure Control Activities—How does management select and develop control activities over the technology infrastructure, which are designed and implemented to help ensure the completeness, accuracy, and availability of technology processing?		
Establishes Relevant Security Management Process Control Activities—How does management select and develop control activities that are designed and implemented to restrict technology access rights to authorized users commensurate with their job responsibilities and to protect the entity's assets from external threats.		
Establishes Relevant Technology Acquisition, Development, and Maintenance Process Control Activities—How does management select and develop control activities over the acquisition, development, and maintenance of technology and its infrastructure to achieve management's objectives.		
(Other entity specific points of focus, if any)		



Principle Evaluation Template — Control Activities						
Deficiencies Applicable to the Principle						
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	
		<div>Exposure Period Version</div>				
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		<Explanation>				
Evaluate the principle using judgment.**		Y/N		Explanation/Conclusion		
Is the principle present?						
Is the principle functioning?						

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## Principle Evaluation Template — Control Activities

Control Activities Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>12. Deploys through Policies and Procedures—The organization deploys control activities through policies that establish what is expected and procedures that put the policies into action.</b>		
Establishes Policies and Procedures to Support Deployment of Management's Directives—How does management establish control activities that are built into business processes and employees' day-to-day activities through policies establishing what is expected, and relevant procedures specifying actions?		
Establishes Responsibility and Accountability for Executing Policies and Procedures—How does management establish responsibility and accountability for control activities with management (or other designated personnel) of the operating unit or function in which the relevant risks reside?		
Performs in a Timely Manner—How do responsible personnel perform control activities in a timely manner as defined by the policies and procedures?		
Takes Corrective Action—How do responsible personnel investigate and act on matters identified as a result of executing control activities?		
Performs Using Competent Personnel—How do competent personnel perform control activities with diligence and continuing focus?		
Reassesses Policies and Procedures—How does management periodically review control activities to determine their continued relevance, and refresh them when necessary?		
(Other entity specific points of focus, if any)		

Principle Evaluation Template — Control Activities						
Deficiencies Applicable to the Principle						
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		<Explanation>				
Evaluate the principle using judgment.**		Y/N		Explanation/Conclusion		
Is the principle present?						
Is the principle functioning?						

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

Principle Evaluation Template — Information and Communication		
Information and Communication Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>13. Uses Relevant Information—The organization obtains or generates and uses relevant, quality information to support the functioning of other components of internal control.</b>		
Identifies Information Requirements—How does management consider if a process is in place to identify the information required and expected to support the functioning of the other components of internal control and the achievement of entity's objectives?		
Captures Internal and External Sources of Data—How do the information systems capture internal and external sources of data?		
Processes Relevant Data into Information—How do the information systems process and transform relevant data into information?		
Maintains Quality throughout Processing—How do the information systems produce information that is timely, current, accurate, complete, accessible, protected, and verifiable and retained? Consider if the information is reviewed to assess its relevance in supporting the internal control components.		
Considers Costs and Benefits—How does management consider if the nature, quantity, and precision of information communicated are commensurate with and support the achievement of objectives?		
(Other entity specific points of focus, if any)		

Principle Evaluation Template — Information and Communication						
Deficiencies Applicable to the Principle						
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		<Explanation>				
Evaluate the principle using judgment.**		Y/N		Explanation/Conclusion		
Is the principle present?						
Is the principle functioning?						

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Principle Evaluation Template — Information and Communication		
Information and Communication Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>14. Communicates Internally—The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control.</b>		
Communicates Internal Control Information with Personnel—What process is in place to communicate required information to enable all personnel to understand and carry out their internal control responsibilities?		
Communicates with the Board of Directors—What communication exists between management and the board of directors so that both have information needed to fulfill their roles with respect to the entity's objectives?		
Provides Separate Communication Lines—Are separate communication channels, such as whistle-blower hotlines, in place and serve as fail-safe mechanisms to enable anonymous or confidential communication when normal channels are inoperative or ineffective?		
Selects Relevant Method of Communication—How does the method of communication consider the timing, audience, and nature of the information?		
(Other entity specific points of focus, if any)		

Principle Evaluation Template — Information and Communication						
Deficiencies Applicable to the Principle						
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		<Explanation>				
Evaluate the principle using judgment.**		Y/N		Explanation/Conclusion		
Is the principle present?						
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\* Note: Record deficiencies in Summary of Deficiencies Template.

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Principle Evaluation Template — Information and Communication		
Information and Communication Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>15. Communicates Externally—The organization communicates with external parties regarding matters affecting the functioning of other components of internal control.</b>		
Communicates to External Parties—What processes are in place to communicate relevant and timely information to external parties, including shareholders, partners, owners, regulators, customers, and financial analysts and other external parties?		
Enables Inbound Communications—How do the open communication channels allow input from customers, consumers, suppliers, external auditors, regulators, financial analysts, and others, providing management and the board of directors with relevant information?		
Communicates with the Board of Directors—How is the relevant information resulting from assessments conducted by external parties communicated to the board of directors?		
Provides Separate Communication Lines—Are separate communication channels, such as whistle-blower hotlines, in place and serve as fail-safe mechanisms to enable anonymous or confidential communication when normal channels are inoperative or ineffective?		
Selects Relevant Method of Communication—How does the method of communication consider the timing, audience, and nature of the communication and legal, regulatory, and fiduciary requirements and expectations?		
(Other entity specific points of focus, if any)		



Principle Evaluation Template — Information and Communication						
Deficiencies Applicable to the Principle						
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	
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Principle Evaluation Template — Monitoring Activities		
Monitoring Activities Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>16. Conducts Ongoing and/or Separate Evaluations—The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.</b>		
Considers a Mix of Ongoing and Separate Evaluations—How does management include a balance of ongoing and separate evaluations?		
Considers Rate of Change—How does management consider the rate of change in business and business processes when selecting and developing ongoing and separate evaluations?		
Establishes Baseline Understanding—How is the design and current state of an internal control system used to establish a baseline for ongoing and separate evaluations?		
Uses Knowledgeable Personnel—How does management help ensure that the evaluators performing ongoing and separate evaluations have sufficient knowledge to understand what is being evaluated?		
Integrates with Business Processes—How do the ongoing evaluations built into the business processes adjust to changing conditions?		
Adjusts Scope and Frequency—How does management vary the scope and frequency of separate evaluations depending on risk?		
Objectively Evaluates—How do the separate evaluations performed periodically provide objective feedback?		
(Other entity specific points of focus, if any)		

Principle Evaluation Template — Monitoring Activities						
Deficiencies Applicable to the Principle						
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		<Explanation>				
Evaluate the principle using judgment.**		Y/N		Explanation/Conclusion		
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Principle Evaluation Template — Monitoring Activities						
Monitoring Activities Principles		Summary of Controls		Deficiencies/Notes/Other Considerations (also record deficiencies in log below)		
<b>17. Evaluates and Communicates Deficiencies—The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.</b>						
Assesses Results—How do management and the board of directors, as appropriate, assess results of ongoing and separate evaluations?						
Communicates Deficiencies—How are deficiencies communicated to parties responsible for taking corrective action and to senior management and to the board of directors, as appropriate?						
Monitors Corrective Actions—How does management track whether deficiencies are remediated on a timely basis?						
(Other entity specific points of focus, if any)						
Deficiencies Applicable to the Principle						
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)	List internal control deficiencies related to another principle that may impact this internal control deficiency	
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	

Principle Evaluation Template — Monitoring Activities		
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>	<Explanation>	
Evaluate the principle using judgment.**	Y/N	Explanation/Conclusion
Is the principle present?		
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#### 4. Summary of Deficiencies Template

[illegible]

This template is an example of a summary of deficiencies. Management may tailor this template to include additional columns to capture other relevant information, as needed.

# Scenarios

## 5. *Scenario A: Is a Principle and Component Present and Functioning?*

### Purpose

- Illustrate how points of focus provide assistance in evaluating and documenting the presence and functioning of principles.
- Illustrate how principles within a specific component roll up into the determination of whether a component is present and functioning.
- Illustrate the need to apply judgment in determining whether principles are present and functioning, including the possibility of having a principle present and functioning despite internal control deficiencies.
- Illustrate the impact of internal control deficiencies at both the principle and component levels.
- Illustrate the customization of relevant points of focus, as appropriate, for the entity.
- Illustrate that the existence of a major deficiency results in a determination that a principle is not present and functioning and, therefore, the associated component is not present and functioning. (Although not specifically shown in this scenario, the overall system of internal control would not be effective.)

### Company Background

- Privately held retail furniture company; family owned.
- \$200 million in annual revenue, exclusively in the western United States
- Board consists of family members and a number of business professionals with significant experience. The managing director has considerable experience in running large businesses. The internal audit director has over fifteen years of auditing experience.

### Objective

- Objective of assessment is internal financial reporting. Specific focus is on generating reliable, complete and accurate divisional financial reports used to run the business and make strategic decisions.



## Relevant Framework Reference(s)

- An effective system of internal control reduces, to an acceptable level, the risk of not achieving an objective relating to one, two, or all three categories. It requires that:
  - Each of the five components of internal control and related relevant principles are present and functioning
  - The five components are operating together in an integrated manner
- When a major deficiency exists with respect to the presence and functioning of a component or relevant principle or with respect to the components operating together, the organization cannot conclude that it has met the requirements for an effective system of internal control.
- The phrase “present and functioning” is applied to components and principles.
  - “Present” refers to the determination that components and relevant principles exist in the design and implementation of the system of internal control.
  - “Functioning” refers to the determination that components and relevant principles continue to exist in the operation and conduct of the system of internal control.
- When a relevant principle is deemed not to be present and functioning, a major deficiency exists in the system of internal control.
- In determining whether a component is present and functioning, senior management and the board of

directors needs to determine to what extent relevant principles are present and functioning. However, a principle being present and functioning does not imply that the organization strives for the highest level of performance in applying that particular principle. Rather, management exercises judgment in balancing the cost and benefit of designing, implementing, and conducting internal control.

- The term “internal control deficiency” refers to a shortcoming in a relevant principle or associated component that has the potential to adversely affect the ability of the entity to achieve its objectives.
- An internal control deficiency or combination of deficiencies that is severe enough to adversely affect the likelihood that the entity can achieve its objectives is referred to as a “major deficiency”. When a major deficiency exists in a component or relevant principle, the organization cannot conclude that it has met the requirements for an effective system of internal control.
- When an organization determines that an internal control deficiency or combination of deficiencies exists, management uses judgment to assess the severity of that deficiency in determining the presence and functioning of the principle, the associated component, and ultimately the entity’s system of internal control.
- Once management has determined which points of focus and relevant for a particular principle, those points of focus become important considerations when assessing the presence and functioning of a principle.

## Facts and Considerations

- Control Environment component used as an example.
- Principle 1 (*The organization demonstrates a commitment to integrity and ethical values.*)
  - Internal control deficiencies noted after evaluating the principle considering relevant points of focus as assistance:
    - There is no formal training program to help make employees aware of the importance of adherence to the standards of conduct.
    - The company does not have processes in place to evaluate individuals against the published integrity and ethics policy.
    - Processes to identify and address deviations are ad-hoc in the organization.
  - Management determined that the combination of internal control deficiencies noted was a major deficiency and, therefore, concluded that principle 1 is not present and functioning.
- Principle 2 (*The board of directors demonstrates independence from management and exercises oversight for the development and performance of internal control.*)
  - Internal control deficiencies noted after evaluating the principle considering relevant points of focus as assistance.
  - Internal control deficiency noted because even though risk assessments are performed and reviewed by management, the board of director's review is not formally documented.
- Internal control deficiency noted because the board does not formally document its review of remediation plans and monitoring activities.
- In its preliminary analysis, management determined that the internal control deficiencies are minor and are compensated for by other controls. These deficiencies do not represent a major deficiency.
- Management concludes that the principle is present and functioning. Despite internal control deficiencies, there are controls in place that mitigate the risk of these internal control deficiencies.
- Principle 3 (*Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.*)
  - Internal control deficiencies noted after evaluating the principle considering relevant points of focus as assistance.
  - Internal control deficiency noted because oversight and control structures have not evolved to keep up with changes in the business.
  - In its preliminary analysis, management determined that the internal control deficiency, though important, did not rise to the level of a major deficiency. Currently, the business structure changes only affect a small portion of the entity.
  - Management concludes that principle 3 is not present and functioning.
- Principle 4 (*The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.*)

- No internal control deficiencies noted.
- Management concludes that principle 4 is present and functioning.
- Note that as part of principle 4, management removed the point of focus Plans and Prepares for Succession as the aspects of this point of focus are now included in the point of focus Evaluates Competence and Addresses Shortcomings.
- Principle 5 (*The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.*)
  - Internal control deficiencies noted after evaluating the principle considering relevant points of focus as assistance.
  - Internal control deficiency noted because bonuses for senior management, division and operating unit leaders are tied directly to financial performance, these bonuses are a large portion of management's compensation, and there is no evidence that any consideration has been given to the pressures that may result or mitigating controls in place.
  - Management determined that the internal control deficiency noted was a major deficiency and, therefore, concluded that principle 5 is not present and functioning.
  - Note that as part of Principle 5, management customized the point of focus Enforces Accountability through Structures, Authorities, and Responsibilities.

- New point of focus reads (changes in bold): "How does management and the board of directors establish the mechanisms to communicate and hold individuals accountable for performance of internal control responsibilities across the organization and implement corrective action as necessary? As part of this process, how does management develop alternative/backup owners for all aspects of internal control?"

## Component Evaluation

- Management concludes that the component is not present and functioning, since two principles are not present and functioning due to the identified major deficiencies. This is a rollup of the principle evaluations.
  - Principle 1—Major deficiency - not present and functioning.
  - Principle 2—Internal control deficiencies (compensating controls noted) —present and functioning.
  - Principle 3—Internal control deficiency(compensating controls noted)—present and functioning.
  - Principle 4—No internal control deficiencies—present and functioning.
  - Principle 5—Major deficiency—not present and functioning.

Note: since management concluded that Control Environment is not present and functioning it would also need to conclude that the overall system of internal control was not effective, although this is not explicitly shown in the scenario.

## Summary of Key Points

- Points of focus can be used to assist management in determining whether a principle is present and functioning.
- The preliminary results of assessing whether a principle is present and functioning supports the assessment at the component level
- Management exercises judgment when determining whether principles are present and functioning, including the possibility of having a principle present and functioning despite internal control deficiencies.
- Internal control deficiencies are evaluated for severity at both the principle and component levels.
- Points of focus may be added or customized to fit the unique facts and circumstances of the entity.
- If a major deficiency is detected in a principle then the principle and its associated component are not present and functioning and the overall system of internal control is not effective.

## Notes on Different Entity Types

- The scenario is equally applicable to all types of entities. However, due to the nature of some entities, certain principles, such as Principle 2 (*The board of directors demonstrates independence from management and exercises oversight for the development and performance of internal control*) may be different in, for example, a governmental entity.

Exposure Period Version

## Component Evaluation Template—Control Environment

Component Evaluation—Control Environment				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
<b>1. Demonstrates Commitment to Integrity and Ethical Values</b> —The organization demonstrates a commitment to integrity and ethical values.		N	N	The appropriate tone at the top is not being set without a formal training program in place and no processes to identify and enforce adherence to the integrity and ethics policies. (see deficiencies CE 1-1, CE 1-2, C1-3).
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
CE 1-1	There is no formal training program to help make employees aware of the importance of adherence to the standards of conduct.	N	There are formally published and communicated ethics and compliance policies.	
CE 1-2	The company does not have processes in place to evaluate individuals against the published integrity and ethics policy.	N	There are formally published and communicated ethics and compliance policies.	
CE 1-3	Processes to identify and address deviations are ah-hoc in the organization.	N	There are formally published and communicated ethics and compliance policies.	

Component Evaluation—Control Environment				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
2. <b>Exercises Oversight Responsibility</b> —The board of directors demonstrates independence from management and exercises oversight for the development and performance of internal control.		Y	Y	The internal control deficiencies noted in Principle 2 (CE 2-1 and CE 2-2) are relatively minor and are compensated for by other controls (see Comments / Compensating Controls).
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
CE 2-1	While the charter indicates that the board should review management's assessment of risk, this review is not formally documented.	N	This is primarily a documentation issue—the board does review the risk assessment.	
CE 2-2	The board does not formally document its review of remediation plans and monitoring activities.	N	Compensating control: The remediation activity and its completion are monitored by operational management. The remediation plans for deficiencies are also reviewed by the board. This is primarily a documentation issue—results of the remediation are reported to the board, but this is not formally documented.	

Component Evaluation—Control Environment				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
<b>3. Establishes Structure, Authority, and Responsibility—</b> Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.		Y	Y	Oversight and control structures have not evolved to keep pace with changes in the business (see deficiency 3-1).
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
CE 3-1	Management has defined and the board of directors has signed off on the company's structures, reporting lines, and authorities and responsibilities; however, the business model has since evolved to encompass business partners, outsourced service providers, and new product lines. As a result, new or different oversight and control structures are needed. Internal control weaknesses relating to this new dimension of the business could therefore be missed and cause the company to fall short of meeting its internal financial reporting objectives.	N	This internal control deficiency is important, but does not rise to the level of a major deficiency. Currently, the business structure changes only affect a small portion of the entity.	

Component Evaluation—Control Environment				
4. <b>Demonstrates Commitment to Competence</b> —The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
		Y	Y	No internal control deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
5. <b>Enforces Accountability</b> —The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
		N	N	The incentive structure represents an internal control deficiency (see internal control deficiency CE 5-1).
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	



Component Evaluation—Control Environment			
CE 5-1	<p>The compensation structure for senior management is heavily weighted toward sales incentive bonuses as compared to salary.</p> <p>There is no evidence that any consideration has been given to the pressures that may result or mitigating controls in place.</p> <p>This may contribute to excessive pressure to meet business targets and produce favorable internal financial reports.</p>	Y	CE 1-1, CE 1-2, CE 1-3
<b>Evaluate deficiencies across the component:*</b>		Explanation/Conclusion	
Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**		Major deficiencies noted in Principles 1 and 5	
Evaluate the component using judgment and based on the principles and the deficiencies.**		Yes/No	Explain
Is the component present?		N	Major deficiencies noted.
Is the component functioning?		N	As the component is not present, it is also not functioning.

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

## Principle Evaluation Template—Control Environment

Principle Evaluation—Control Environment		
Control Environment Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>1. Demonstrates Commitment to Integrity and Ethical Values—The organization demonstrates a commitment to integrity and ethical values.</b>		
<b>Sets the Tone at the Top</b> —How does the board of directors and management at all levels of the entity demonstrate through their directives, actions, and behavior the importance of integrity and ethical values to support the functioning of the system of internal control?	The organization has a policy on the importance of integrity and ethics throughout the organization.	
<b>Establishes Standards of Conduct</b> —How are the expectations of the board of directors and senior management concerning integrity and ethical values defined in the entity's standards of conduct and understood at all levels of the organization and by outsourced service providers and business partners?	The board of directors and senior management have formulated a set of policies on integrity and ethics, and these policies are regularly flashed on the firm's internal portal, and in newsletters as well as being incorporated into the contracts with outsourced service providers.	There is no formal training program to help make employees aware of the importance of adherence to the standards of conduct (CE 1-1)
<b>Evaluates Adherence to Standards of Conduct</b> —What processes are in place to evaluate the performance of individuals and teams against the entity's expected standards of conduct?	It is up to the management of each operating unit to evaluate adherence to the organization's integrity and ethics policies. In most cases, this is not conducted.	There are no formal processes in place to evaluate individuals against the published integrity and ethics policies (CE 1-2)
<b>Addresses Deviations in a Timely Manner</b> —How are deviations of the entity's expected standards of conduct identified and remedied in a timely and consistent manner?	It is up to the management of each operating unit to identify and address deviations against the organization's integrity and ethics policies. Normally, this only occurs when management is specifically made aware of a situation.	Processes to identify and address deviations are ah-hoc in the organization. (CE 1-3)
(Other entity specific points of focus, if any)		

## Principle Evaluation—Control Environment

Deficiencies Applicable to the Principle					
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)	List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls
CE 1-1	There is no formal training program to help make employees aware of the importance of adherence to the standards of conduct	N	N	N	There are formally published and communicated ethics and compliance policies
CE 1-2	The company does not have processes in place to evaluate individuals against the published integrity and ethics policy	N	N	N	There are formally published and communicated ethics and compliance policies
CE 1-3	Processes to identify and address deviations are ah-hoc in the organization.	N	N	N	There are formally published and communicated ethics and compliance policies
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		The combination of the internal control deficiency noted in the Principle 1 (CE 1-1, CE1-2 and CE 1-3) are a major deficiency. While there are formally published and communicated ethics and compliance policies, without training to make people aware of the policies, and processes to evaluate individuals against deviations and identify and address deviations, the organization is not setting a tone that violating the policies is unacceptable.  <i>[Author's note: Once management determines that the internal control deficiencies, when considered across the principle, rise to the level of a major deficiency, management would need to go back and adjust the preliminary severity analysis to reflect each internal control deficiency as a major deficiency.]</i>			
Evaluate the principle using judgment.**		Y/N	Explanation/Conclusion		
Is the principle present?		N	Due to the major deficiency in the principle, the principle is not present.		
Is the principle functioning?		N	As the principle was not present, it is also not functioning.		

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

Principle Evaluation—Control Environment		
Control Environment Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>2. Exercises Oversight Responsibility—The board of directors demonstrates independence from management and exercises oversight for the development and performance of internal control.</b>		
<b>Establishes Oversight Responsibilities</b> —How does the board of directors identify and accept its oversight responsibilities in relation to established requirements and expectations?	The board of directors has a charter that is comprehensive and outlines the board's oversight responsibilities in a manner consistent with the entity's regulatory environment and expectations.	
<b>Applies Relevant Expertise</b> —How does the board of directors define, maintain, and periodically evaluate the skills and expertise needed among its members to enable them to ask probing questions of senior management and take commensurate actions?	The board consists of family members and a number of business professionals with significant experience. The managing director has considerable experience in running large businesses.	
<b>Operates Independently</b> —Does the board of directors have sufficient members who are independent from management, and how do they demonstrate they are objective in evaluations and decision making?	There are a number of board members who come from outside organizations and who have a variety of experience.	
<b>Provides Oversight for the System of Internal Control</b> —How does the board of directors retain oversight responsibility for management's development and performance of internal control (see areas below)?	The board of directors has delegated certain responsibilities to its committees, and each committee has a well-defined charter delineating its responsibilities in the context of the entity's regulatory environment and expectations. (Also, see sub-points of focus below.)	The absence of formal documentation of the risk assessment review and remediation plans by the board represents internal control deficiencies.
<b>Control Environment</b> —Establishing integrity and ethical values, oversight structures, authority and responsibility, expectations of competence, and accountability to the board.	The charter for the board clearly establishes the need for integrity and ethical values and outlines the organizational structure from the top down along with requirements for integrity, ethics, competence, and accountability at each level.	
<b>Risk Assessment</b> —Overseeing management's assessment of risks to the achievement of objectives, including the potential impact of significant changes, fraud, and management override of internal control.	The charter indicates that the board should review management's assessment of risk.	While the charter indicates that the board should review management's assessment of risk, this review is not formally documented. (CE 2-1).

## Principle Evaluation—Control Environment

<b>Control Activities</b> —Providing oversight to senior management in the development and performance of control activities.		The board has reviewed the proposed control activities listing and provided their feedback and guidance. The list of control activities and the internal control plan is presented annually by the compliance director.			
<b>Information and Communication</b> —Analyzing and discussing information relating to the entity's achievement of objectives.		The executive committee regularly reports on the progress of the organization and the achievement of their internal financial reporting objectives.			
<b>Monitoring Activities</b> —Assessing and overseeing the nature and scope of monitoring activities and the management's evaluation and remediation of deficiencies.		Every deficiency is analyzed by management and a corresponding remediation plan is provided to the board. However, the board does not formally document its review of the closure of the remediation activities.		The board does not formally document its review of remediation plans and monitoring activities. (CE 2-2).	
(Other entity specific points of focus, if any)					
Deficiencies Applicable to the Principle					
Identification No.	Internal control deficiency description	Possible Impact on Principle		<b>Evaluate preliminary deficiency severity:</b> (Consider whether other controls to effect this principle compensate for the internal control deficiency.)	List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls
CE 2-1	While the charter indicates that the board should review management's assessment of risk, this review is not formally documented.	Y	N	N	This is primarily a documentation issue—the board does review the risk assessment.

Principle Evaluation—Control Environment					
CE 2-2	The board does not formally document its review of remediation plans and monitoring activities.	Y	N	N	Compensating control: The remediation activity and its completion are monitored by operational management. The remediation plans for deficiencies are also reviewed by the board. This is primarily a documentation issue—results of the remediation are reported to the board, but this is not formally documented.
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		The internal control deficiencies noted in Principle 2 are minor and are compensated for by other controls (see comments in deficiencies CE 2-1 and CE 2-2). These deficiencies do not represent a major deficiency.			
Evaluate the principle using judgment.**		Y/N	Explanation/Conclusion		
Is the principle present?		Y	Internal control deficiencies noted have compensating controls. See comments in deficiencies CE 2-1 and CE 2-2.		
Is the principle functioning?		Y	Internal control deficiencies noted have compensating controls. See comments in deficiencies CE 2-1 and CE 2-2.		

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

Principle Evaluation—Control Environment				
Control Environment Principles		Summary of Controls		Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>3. Establishes Structure, Authority, and Responsibility—Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.</b>				
Considers All Structures of the Entity—How does management and the board of directors consider the multiple structures used (including operating units, legal entities, geographic distribution, and outsourced service providers) to support the achievement of objectives?		The design of the internal control system and the internal financial reporting objectives are discussed at the board meetings. The internal control organization design is evaluated jointly by both the board and management.		Management has defined and the board of directors has signed off on the company's structures, reporting lines, and authorities and responsibilities; however, the business model has since evolved to encompass business partners, outsourced service providers, and new product lines so that new or different oversight and control structures are needed. (CE 3-1)
Establishes Reporting Lines—How does management design and evaluate lines of reporting for each entity structure to enable execution of authorities and responsibilities and flow of information to manage the activities of the entity?		The reporting and related governance structure is designed through consultation with the governance committee constituted by a competent senior management team.		
Defines, Assigns, and Limits Authorities and Responsibilities—How does management and the board of directors delegate authority, define responsibilities, use appropriate process and technology to assign responsibilities and segregate duties as necessary at the various levels of the organization?		The governance committee works with the controller to ensure that responsibilities are clearly defined and the controls around segregation of duties are adequately designed.		
(Other entity specific points of focus, if any)				
Deficiencies Applicable to the Principle				
Identification No.	Internal control deficiency description	Possible Impact on Principle	Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)	List internal control deficiencies related to another principle that may impact this internal control deficiency

Principle Evaluation—Control Environment						
		Present? (Y/N)	Function- ing? (Y/N)	Preliminary Sever- ity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compen- sating Controls	
CE 3-1	Management has defined and the board of directors has signed off on the company's structures, reporting lines, and authorities and responsibilities; however, the business model has since evolved to encompass business partners, outsourced service providers, and new product lines so that new or different oversight and control structures are needed. Internal control weaknesses relating to this new dimension of the business could therefore be missed and cause the company to fall short of meeting its internal financial reporting objectives.	Y	Y	N	This internal control deficiency is important, but does not rise to the level of a major deficiency. Currently, the business structure changes only affect a small portion of the entity.	
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		In its preliminary analysis, it has been determined that the internal control deficiency noted in Principle 3 (CE 3-1), though important, did not rise to the level of a major deficiency.				
Evaluate the principle using judgment		Y/N	Explanation/Conclusion			
Is the principle present?		N	Oversight and control structures have not evolved to keep pace with changes in the business. Though the preliminary analysis determined that this internal control deficiency did not rise to the level of a major deficiency, it has been determined that the principle was not present.			
Is the principle functioning?		N	As the principle was not present, it is also not functioning.			

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.



Principle Evaluation—Control Environment		
Control Environment Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>4. Demonstrates Commitment to Competence—The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.</b>		
<b>Establishes Policies and Practices</b> —How do the policies and practices reflect expectations of competence necessary to support the achievement of objectives?	The competency framework is embedded into the policies and procedures of the organization. Specifically, there are sections of the policies and procedures that focus on the capabilities required at each level to effectively execute the controls around financial reporting.	
<b>Evaluates Competence and Addresses Shortcomings</b> —How does the board of directors and management evaluate competence across the organization and in outsourced service providers in relation to established policies and practices, and act as necessary to address shortcomings?	The internal control team evaluates and reports on the competency of the organization as well as the outsourced service providers. These reports are evaluated and gaps addressed by the management and the board.	
<b>Attracts, Develops and Retains Individuals</b> —How does the organization provide the mentoring and training needed to attract, develop, and retain sufficient and competent personnel and outsourced service providers to support the achievement of objectives?	The organization has a robust training and mentoring framework to guide and support individuals and service providers on the expectations from an organization policy point of view.	
<b>Plans and Prepares for Succession</b> —How does the senior management and the board of directors develop contingency plans for assignments of responsibility important for internal control?		This point of focus is not relevant to the organization. The key concepts of this point of focus have been added to the point of focus <i>Enforces Accountability through Structures, Authorities, and Responsibilities</i> in Principle 5.
(Other entity specific points of focus, if any)		

## Principle Evaluation—Control Environment

### Deficiencies Applicable to the Principle

Identification No.	Internal control deficiency description	Possible Impact on Principle	<b>Evaluate preliminary deficiency severity:</b> (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls
N/A					
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** <Update Summary of Deficiencies Template as required>		No internal control deficiencies noted.			
<b>Evaluate the principle using judgment.**</b>		Y/N	Explanation/Conclusion		
Is the principle present?		Y	No internal control deficiencies noted.		
Is the principle functioning?		Y	No internal control deficiencies noted.		

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

Principle Evaluation—Control Environment		
Control Environment Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>5. Enforces Accountability—The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.</b>		
Enforces Accountability through Structures, Authorities, and Responsibilities—How does management and the board of directors establish the mechanisms to communicate and hold individuals accountable for performance of internal control responsibilities across the organization and implement corrective action as necessary? As part of this process, how does management develop alternative/backup owners for all aspects of internal control?	There are clear responsibilities within the organizational structure related to the execution of controls supporting the internal financial reporting objective. These responsibilities are annually reviewed by the board.	This point of focus has been customized to reflect the assignment of backup owners for internal controls.
Establishes Performance Measures, Incentives, and Rewards—How does management and the board of directors establish performance measures, incentives, and other rewards appropriate for responsibilities at all levels of the entity, reflecting appropriate dimensions of performance and expected standards of conduct, and considering the achievement of both short-term and longer-term objectives?	The responsibility and related organizational structure is tied to a transparent evaluation framework that incorporates good practices, which encourages desirable and responsible behavior.	
Evaluates Performance Measures, Incentives, and Rewards for Ongoing Relevance—How does management and the board of directors align incentives and rewards with the fulfillment of internal control responsibilities in the achievement of objectives?	There is a top-down performance reward system that is tied to internal control responsibilities for most personnel.	

## Principle Evaluation—Control Environment

Considers Excessive Pressures—How do management and the board of directors evaluate and adjust pressures associated with the achievement of objectives as they assign responsibilities, develop performance measures, and evaluate performance?		The board evaluates the performance of the management team through discussions and reviews rather than just tracking numerical metrics.		The compensation structure for senior management is heavily weighted toward sales incentive bonuses as compared to salary. (CE 5-1)	
Evaluates Performance and Rewards or Disciplines Individuals—How do management and the board of directors evaluate performance of internal control responsibilities, including adherence to standards of conduct and expected levels of competence and provide rewards or exercise disciplinary action as appropriate?		Performance is reviewed against established internal control goals and responsibilities established at the beginning of the year. There is also a review of the internal control organization and issues are traced to the individuals and teams responsible. Appropriate rewards and/or enforcement actions are exercised. This is reviewed quarterly by the board.			
(Other entity specific points of focus, if any)					
Deficiencies Applicable to the Principle					
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)	List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls

Principle Evaluation—Control Environment						
CE 5-1	<p>The compensation structure for senior management is heavily weighted toward sales incentive bonuses as compared to salary.</p> <p>There is no evidence that any consideration has been given to the pressures that may result or mitigating controls in place.</p> <p>This may contribute to excessive pressure to meet business targets and produce favorable internal financial reports.</p>	N	N	Y		<p>The incentive compensation puts pressure on senior management to act unethically. The major deficiency in principle 1 does not set a tone that unethical behaviour is unacceptable in the organization.</p>
<p><b>Evaluate deficiencies within the principle:*</b></p> <p>Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.**</p> <p>&lt;Update Summary of Deficiencies Template as required&gt;</p>		The internal control deficiency noted in the Principle (CE 5-1) is a major deficiency.				
Evaluate the principle using judgment.**		Y/N	Explanation/Conclusion			
Is the principle present?		N	Due to the major deficiency (CE 5-1) in the principle, the principle is not present.			
Is the principle functioning?		N	As the principle was not present, it is also not functioning.			

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

## 6. *Scenario B*: Are the Five Components Present, Functioning and Operating Together in an Integrated Manner?

### Purpose

- Illustrate how the overall assessment of internal control is performed by considering the determination of whether the five components are present and functioning.
- Illustrate how to assess whether the components are operating together in an integrated manner.

### Company Background

- Publicly held midsized manufacturing company with 1,000-plus employees. The organization specializes in manufacturing parts for aerospace applications. Unit A has been supplying parts to an airline manufacturer customer for thirty years. These parts are specialized, requiring precision processes to manufacture, and they are expected to be extremely high quality. Last year, the customer asked for a new part which is a component of a new product. The manufacturing process for this part uses newer technology and involves changes in the manufacturing process.

### Objective

- Management is assessing effectiveness over the operations objective.

### Relevant Framework Reference(s)

- An effective system of internal control reduces, to an acceptable level, the risk of not achieving an objective relating to one, two, or all three categories. It requires that:
  - Each of the five components of internal control and relevant principles are present and functioning
  - The five components are operating together in an integrated manner
- The Framework views all components of internal control as suitable and relevant to all entities, and therefore requires that all components be present and functioning and operating together in an integrated manner. Evaluating whether each component of internal control is present and functioning and whether the components are operating together requires consideration of how each component and relevant principles are being applied by the entity within the system of internal control. Components should not be viewed

discretely; instead, they must operate together as an integrated system. Each of the five components operating together help to collectively reduce, to an acceptable level, the risk of not achieving an objective. When a component is deemed not to be present and functioning, or when components do not operate together, a major deficiency exists.

- The term “internal control deficiency” refers to a shortcoming in a relevant principle or associated component of the system of internal control that has the potential to adversely affect the ability of the entity to achieve its objectives.
- An internal control deficiency or combination of deficiencies that is severe enough to adversely affect the likelihood that the entity can achieve its objectives is referred to as a “major deficiency”. When a major deficiency exists in a component or relevant principle, the organization cannot conclude that it has met the requirements for an effective system of internal control.
- When an organization determines that an internal control deficiency or combination of deficiencies exists, management uses judgment to assess the severity of that deficiency in determining the presence and functioning of the principle, the associated component, and ultimately the entity’s system of internal control.

## Facts and Circumstances

### Control Environment

- Principle 4 (*The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.*)
  - Internal control deficiency noted relating to the lack of an effective learning and development program. Based on its judgment, and considering the strength of the other principles in the component, management makes a preliminary determination that Control Environment is present and functioning.

### Risk Assessment

- Principle 9 (*The organization identifies and assesses changes that could significantly impact the system of internal control.*)
  - Internal control deficiency noted relating to some operations personnel not possessing the skills and competency to identify risks associated with the new technology. Based on its judgment, and considering the strength of the other principles in the component, management makes a preliminary determination that Risk Assessment is present and functioning.

## Control Activities

- Principle 12 (*The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.*)
  - Internal control deficiency noted relating to individuals who are not well trained. Based on its judgment, and considering the strength of the other principles in the component, management makes a preliminary determination that Control Activities is present and functioning.

## Information and Communication

- Based on its judgment, management makes a preliminary determination that Information and Communication is present and functioning with no internal control deficiencies.

## Monitoring Activities

- Principle 16 (*The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.*)
  - Internal control deficiency noted relating to individuals who may not be knowledgeable in the new technology and underlying business processes. Based on its judgment, and considering the strength of the other principles in the component, management makes a preliminary determination that Monitoring Activities is present and functioning.

## Overall System of Internal Control

- Management reviewed the internal control deficiencies across the entity to determine if the components were operating together in an integrated manner. Management noted several internal control deficiencies where competency was a contributing factor. The requirement for maintenance of the highest quality standards and the resulting low-risk tolerance for defective manufacture reveal a concern about the lack of a commensurate training and competency framework that pervades the organization. The reviewers noted that the individuals are experienced and knowledgeable, but the new manufacturing requirements requiring them to quickly adapt to changes have become difficult due to the lack of a “competency training culture.” This situation has the potential of affecting the business objective of providing quality within the tolerance levels prescribed by the customer. Therefore, management needs to determine whether the internal control deficiency in Principle 4, when considered with the other factors listed above, rises to the level of a major deficiency.
- In this scenario, based on considerations when evaluating the components together, management concludes that a major deficiency exists and thus the overall system of internal controls is not effective. (Note that the templates presented show management’s preliminary determination of the severity of the deficiencies. With the updated determination, management would likely change the templates to reflect that the internal control deficiencies that were initially not deemed to be major have been reclassified as major and the associated components and principles are not present and functioning.)



## Summary of Key Points

- To assess whether the system of internal control is effective, management must consider whether each of the components is present and functioning and whether the components are operating together in an integrated manner. Management needs to determine using judgment whether any internal control deficiencies or combination of deficiencies, when considered collectively across the components, represent a major deficiency to determine whether the components are operating together in an integrated manner.

## Notes on Different Entity Types

- The scenario is equally applicable to all types of entities. However, due to the nature of some of these entities, certain principles, such as Principle 2, (*The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control*) may be somewhat different. For example, a private entity may not have an independent board of directors, but it may have an advisory board that exhibits independence from the day-to-day management of the company.

## Overall Evaluation of Internal Control Template

Assessment of Internal Control			
Entity or part of organization structure subject to the assessment (entity, division, operating unit, function)		Manufacturing division supplying parts for aerospace industry	
Objective(s) being considered for the scope of internal control being assessed		Considerations regarding management's acceptable level of risk	
Operations	Quality of parts within the tolerance levels prescribed by customers	0.1% variation from specifications tolerance for parts manufactured for customers	
Reporting			
Compliance			
		Present? (Y/N)	Functioning? (Y/N)
Control Environment		Y	Y
Risk Assessment		Y	Y
Control Activities		Y	Y
Information and Communication		Y	Y
Monitoring Activities		Y	Y
<b>Are all components operating together in an integrated manner?</b>		Components are not operating together in an integrated manner.	
Evaluate if a combination of internal control deficiencies, when considered across components, represent a major deficiency.* <Update Summary of Deficiencies Template as needed>		In the preliminary evaluation of principles and components, the internal control deficiencies noted (CE 4-1, RA 9-1, CA 12-1, MA 16-1) were not classified as major deficiencies.* However, when evaluating the components together, it was noted that most of the deficiencies related to competence (see Principle 4, Demonstrates Commitment to Competence). Therefore, it is our judgment that, together, these deficiencies indicate a major deficiency and that the components are not operating together in an integrated manner. <sup>5</sup>	
Is the overall system of internal control effective? <Y/N>*		N	
Basis for conclusion		Based on considerations when evaluating the components together, it is our judgment that a major deficiency exists. Therefore, the overall system of internal controls is not effective.	

\* If it is determined that there is a major deficiency, then management must conclude that the overall system of internal control is not effective.

<sup>5</sup> Given this determination, management would likely update the templates to reflect that the deficiencies have been reclassified as major and the associated components and principles are not present and functioning.

## Component Evaluation Template—Control Environment

Component Evaluation—Control Environment				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
<b>1. Demonstrates Commitment to Integrity and Ethical Values</b> —The organization demonstrates a commitment to integrity and ethical values.		Y	Y	The company has a history of integrity and ethical behavior. All employees must annually read and sign a code of conduct. Our policies consistently encourage adherence to a high degree of integrity and ethical behavior.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
<b>2. Exercises Oversight Responsibility</b> —The board of directors demonstrates independence from management and exercises oversight for the development and performance of internal control.		Y	Y	The board of directors bears no personal or professional relationship with management and provides guidance, direction, and challenge to management regarding internal control processes throughout the company.

Component Evaluation—Control Environment				
Identification No.	Internal control deficiency description	Evaluate internal control deficiency severity: (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
	3. <b>Establishes Structure, Authority, and Responsibility—</b> Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.	Y	Y	The company has a very clear organizational structure with well-defined roles and responsibilities, including well-staffed operations and quality assurance departments.
Identification No.	Internal control deficiency description	Evaluate internal control deficiency severity: (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				

Component Evaluation—Control Environment				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
4. <b>Demonstrates Commitment to Competence</b> —The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.		Y	Y	
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
CE 4-1	The organization relies on experienced hires from the industry but does not have an effective formal learning and development program to continually train and potentially improve the skill level of the existing employees.	N	Though there is no formal training program, there is an informal method to develop and upgrade talent through a mentoring process. Because there is normally little change in the business the lack of a formal training program is not considered severe enough to be a major deficiency.	

Component Evaluation—Control Environment			
5. <b>Enforces Accountability</b> —The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.		Present? (Y/N) Y	Functioning? (Y/N) Y
		Explanation/Conclusion The vice-president of operations and the head of quality assurance are held accountable for achieving objectives associated with internal controls	
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.) Is internal control deficiency a major deficiency? (Y/N)	
		Comments/Compensating Controls	List internal control deficiencies related to another principle that may impact this internal control deficiency
N/A			
		Explanation/Conclusion	
<b>Evaluate deficiencies across the component:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**		Based on preliminary analysis at the principle level, one internal control deficiency was noted. No major deficiencies were noted.	
Evaluate the component using judgment and based on the principles and the deficiencies.**		Yes/No	Explanation/Conclusion
Is the component present?		Yes	While an internal control deficiency (CE 4-1) was identified in Principle 4 (Demonstrates Commitment to Competence) it was not considered a major deficiency and all principles were determined to be present.
Is the component functioning?		Yes	While an internal control deficiency (CE 4-1) was identified in Principle 4 (Demonstrates Commitment to Competence) it was not considered a major deficiency and all principles were determined to be functioning.

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

## Component Evaluation Template—Risk Assessment

Component Evaluation—Risk Assessment				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
6. <b>Specifies Suitable Objectives</b> —The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.		Y	Y	Objectives within the organization are clearly defined. Objectives are focused on controlling costs and managing defects and are very specific based on historical performance and organizational goals.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
7. <b>Identifies and Analyzes Risks</b> —The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.		Y	Y	Based on the objectives defined during the annual process, risks are identified by the senior team and reviewed by the head of quality assurance.
Identification No.	Internal control deficiency description	Is internal control deficiency a major deficiency? (Y/N)		
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
8. <b>Assesses Fraud Risk</b> —The organization considers the potential for fraud in assessing risks to the achievement of objectives.		Y	Y	The organization has policies, procedures, and controls around fraud identification and remediation.

Component Evaluation—Risk Assessment				
Identification No.	Internal control deficiency description	Evaluate internal control deficiency severity: (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
9. <b>Identifies and Analyzes Significant Change</b> —The organization identifies and assesses changes that could significantly impact the system of internal control.		Y	Y	As part of the risk assessment process, we have considered changes to the organizational structure, systems environment, and financial environment.
Identification No.	Internal control deficiency description	Evaluate internal control deficiency severity: (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
RA 9-1	Some operations personnel do not possess the necessary skills to identify the risks associated with the new technology.	N	Though operations personnel are not trained in the new technology, management believes they are knowledgeable enough to identify risks.	Linked to internal control deficiency CE 4-1 in Principle 4 ( <i>Demonstrates Commitment to Competence</i> )
		Explanation/Conclusion		
<b>Evaluate deficiencies across the component:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**		Based on preliminary analysis at the principle level, one internal control deficiency was noted in Principle 9 (RA 9-1). No major deficiencies were noted.		



Component Evaluation—Risk Assessment		
Evaluate the component using judgment and based on the principles and the deficiencies.**	Yes/No	Explanation/Conclusion
Is the component present?	Yes	Despite the internal control deficiency noted in Principle 9 (RA 9-1), we determined that the Risk Assessment component is present.
Is the component functioning?	Yes	Despite the internal control deficiency noted in Principle 9 (RA 9-1), we determined that the Risk Assessment component is functioning.

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

Exposure Period Version

## Component Evaluation Template—Control Activities

Component Evaluation—Control Activities				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
10. <b>Selects and Develops Control Activities</b> —The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.		Y	Y	The organization has developed control activities that link to the risks identified in the risk assessment process.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.) Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
11. <b>Selects and Develops General Controls over Technology</b> —The organization selects and develops general control activities over technology to support the achievement of objectives.		Y	Y	The organization has controls over technology, including controls around access to systems, change management, and the technology infrastructure.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.) Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		
N/A				

Component Evaluation—Control Activities				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
12. <b>Deploys through Policies and Procedures</b> —The organization deploys control activities through policies that establish what is expected and procedures that put the policies into action.		Y	Y	The organization maintains robust policies that clearly outline expectations that support the objectives and principles of their control environment. Also, procedures are in place that support these policies. However, in some cases, the staff lacks the competency to properly implement the procedures.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
CA 12-1	The policies and related procedures are thorough and robust. However, the staff is not formally trained on the policies and procedures. Production errors have occurred because new hires were not formally trained on the procedures.	N	Most staff have been with the company for a long time and the issues to date have been minor and subsequently corrected.	Linked to internal control deficiency (CE 4-1) noted in Principle 4 ( <i>Demonstrates Commitment to Competence</i> )
		Explanation/Conclusion		
<b>Evaluate deficiencies across the component:*</b>  Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**		Based on preliminary analysis at the principle level, an internal control deficiency was noted in Principle 12. No major deficiencies were noted.		

Component Evaluation—Control Activities		
Evaluate the component using judgment and based on the principles and the deficiencies.**	Yes/No	Explanation/Conclusion
Is the component present?	Yes	Despite the internal control deficiency noted in Principle 12, we determined that the Control Activities component is present.
Is the component functioning?	Yes	Despite the internal control deficiency noted in Principle 12, we determined that the Control Activities component is functioning.

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

# Exposure Period Version

## Component Evaluation Template—Information and Communication

Component Evaluation—Information and Communication				
13. <b>Uses Relevant Information</b> —The organization obtains or generates and uses relevant, quality information to support the functioning of other components of internal control.		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
		Y	Y	Information policies are well developed, and relevant, quality information is generated to support all aspects of internal control.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
14. <b>Communicates Internally</b> —The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control.		Y	Y	Objectives and internal control responsibilities are clearly communicated on a quarterly basis.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				

Component Evaluation—Information and Communication				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
15. <b>Communicates Externally</b> —The organization communicates with external parties regarding matters affecting the functioning of other components of internal control.		Y	Y	Several external communications are in place, such as our robust customer feedback and supplier partner programs.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Explanation/Conclusion		
<b>Evaluate deficiencies across the component:*</b>		No internal control deficiencies noted.		
Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**				
Evaluate the component using judgment and based on the principles and the deficiencies.**		Yes/No	Explanation/Conclusion	
Is the component present?		Yes	No internal control deficiencies noted.	
Is the component functioning?		Yes	No internal control deficiencies noted.	

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

## Component Evaluation Template—Monitoring Activities

Component Evaluation—Monitoring Activities				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
16. <b>Conducts Ongoing and/or Separate Evaluations</b> —The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.		Y	Y	The quality organization conducts internal operational reviews with input and oversight from internal audit. However, not all operations staff responsible for the evaluations are adequately trained and experienced in the new technology.
Identification No.	Internal control deficiency description	Evaluate internal control deficiency severity: (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
MA16-1	The personnel performing the formal reviews, while experienced, do not receive formal training on the new technology and processes. As a result, the initial drafts of some reports of findings require corrections.	N	This internal control deficiency is partially mitigated by having experienced senior management review the reports who have been able to correct the findings based on their skill and experience.	Linked to internal control deficiency (CE 4-1) noted in Principle 4 ( <i>Demonstrates Commitment to Competence</i> )

Component Evaluation—Monitoring Activities				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
17. <b>Evaluates and Communicates Deficiencies</b> —The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.		Y	Y	As part of its internal efficiency reviews, the organization evaluates deficiencies noted, identifies responsibility, and communicates results to senior management.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Explanation/Conclusion		
<b>Evaluate deficiencies across the component:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**		Based on a preliminary analysis at the principle level, one internal control deficiency was noted in Principle 16. This was not deemed a major deficiency and there was no combination of deficiencies to consider.		
Evaluate the component using judgment and based on the principles and the deficiencies.**		Yes/No	Explanation/Conclusion	
Is the component present?		Yes	Despite the internal control deficiency noted in Principle 16, we determined that all Monitoring Activity principles were present and the component is present.	
Is the component functioning?		Yes	Despite the internal control deficiency noted in Principle 16, we determined that the Monitoring Activities component is functioning.	

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.



Summary of Deficiencies Template									
ID #	Source of the internal control deficiency		Internal Control Deficiency Description	Severity Considerations	Is internal control deficiency a major deficiency? (Y/N)	Owner	Remediation Plan and Date	Impact on Present/ Functioning	List any internal control deficiencies in other principles that may have contributed to this internal control deficiency
	Component	Principle							
CE 4-1	CE	4	The organization relies on experienced hires from the industry but does not have an effective learning and development program to continually train and potentially improve the skill level of the existing employees.	This internal control deficiency relates to competency issues. See Overall Evaluation of Internal Control Template.	N	John XYZ	See "Remediation Action Plan" memo	Principle present and functioning Component present and functioning	
RA 9-1	RA	9	Some operations personnel do not possess the necessary skills to identify the risks associated with the new technology.	This internal control deficiency relates to competency issues. See Overall Evaluation of Internal Control Template.	N	Jane ABC	See "Remediation Action Plan" memo	Principle present and functioning Component present and functioning	CE 4-1
CA 12-1	CA	12	The policies and related procedures are thorough and robust. However, the staff is not formally trained on the policies and procedures. Production errors have occurred because new hires were not formally trained on the procedures.	This internal control deficiency relates to competency issues. See Overall Evaluation of Internal Control Template.	N	Jeff CDE	See "Remediation Action Plan" memo	Principle present and functioning Component present and functioning	CE 4-1

Summary of Deficiencies Template									
ID #	Source of the internal control deficiency		Internal Control Deficiency Description	Severity Considerations	Is internal control deficiency a major deficiency? (Y/N)	Owner	Remediation Plan and Date	Impact on Present/ Functioning	List any internal control deficiencies in other principles that may have contributed to this internal control deficiency
	Component	Principle							
MA 16-1	MA	16	The personnel performing the formal reviews, while experienced, do not receive formal training on the new technology and processes. As a result, the initial drafts of some reports of findings require corrections.	This internal control deficiency relates to competency issues. See Overall Evaluation of Internal Control Template.	N	Joe FGH	See "Remediation Action Plan" memo	Principle present and functioning Component present and functioning	CE 4-1

## 7. Scenario C: How Does a Material Weakness in a Control Activity Impact Principles, Components, and Internal control?

### Purpose

- Illustrate how a material weakness identified at the transaction control activity level is considered in the evaluation of principles and components, and in the assessment of the effectiveness of the system of internal control.

### Company Background

- Public financial services company.
- Three divisions:
  - Division A
  - Division B
  - Division C

### Objective

- External financial reporting objective.<sup>6</sup>

### Relevant Framework Reference(s)

- When an organization determines that an internal control deficiency or combination of deficiencies exists, management uses judgment to assess the severity of that deficiency in determining the presence and functioning of the principle, the associated component, and ultimately the entity's system of internal control. Regulators, standard-setting bodies, and other relevant third parties may establish criteria for evaluating the severity and corresponding classification and reporting of deficiencies relating to external reporting objectives, operations, and compliance objectives. As well, for internal reporting and other operations objectives, management and board of directors establish objective criteria for evaluating internal control deficiencies and reporting to those responsible for achieving these objectives. The Framework does not prescribe such criteria, but recognizes and accommodates the authority and responsibility of those other parties that interact with the entity to issue such laws, rules, regulations, and standards for conducting assessments and classifications.

<sup>6</sup> Author's Note: Because the objective is external financial reporting, this scenario uses terms as defined by the Securities and Exchange Commission in the United States, significant deficiency, and material weakness. Therefore, in this scenario management has customized the templates to reflect this classification.

## Facts and Circumstances

- A material weakness was identified by management in the company's revenue process. One of the revenue streams for the company did not have sufficient controls, and it was determined that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, detected, or corrected on a timely basis. There were no known material misstatements in the company's financial statements during the current period.
- A root cause analysis determined that management failed to establish control activities over a significant revenue process in Division C. This division was small but growing and had not implemented extensive financial controls to help foster the entrepreneurial nature of the division. Division C grew to a significant portion of the overall organization's revenue during the year, but sufficient controls were never implemented.
- A related material weakness was noted in Principle 14 (*The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control*).
- Management determined there was a deficiency in the system of internal control that led to the material weakness.
- Due to the material weaknesses management concluded that:
  - Principle 10 (*The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels*) is not present and functioning.
  - The Control Activities component is not present and functioning
  - Principle 14 (*The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control*) is not present and functioning.
  - The Information and Communication component is not present and functioning. Note: the Information and Communication component template is not included in this scenario and the principle template for Principle 14 is not included in this scenario.
  - There is a reasonable possibility that a material misstatement of the organization's financial statements would not be prevented, detected, or corrected on a timely basis.
  - The system of internal control is not effective.

## Summary of Key Points

- The material weaknesses identified related to transaction-level control activities leads management to determine that the Control Activities and Information and Communication components are not present and functioning and the system of internal control to be ineffective. Material weaknesses were identified, though there were no known actual material misstatements of the financial statements.
- Management should determine the root cause of the material weaknesses by considering which control activity principles were not present and functioning. The points of focus can assist in this determination. For example, in this scenario, adequate control activities were never built into the process in the first place because the process to determine the relevant business processes under Principle 10 did not work appropriately.
- As COSO is an integrated framework, there are likely contributing factors to a material weakness in a particular component. In this scenario at least one of the contributing factors was a breakdown in internal communications within the organization that the revenue in Division C had become material in the current fiscal year. This is reflected in the related material weakness identified in Principle 14 (Communicates Internally).
- To have an effective system of internal control under the Framework, management needs to correct the specific material weaknesses by selecting and developing adequate control activities for the revenue process at this division, and remediate any of the internal control deficiencies that led or contributed to the material weakness, namely the process issues of

identifying relevant business processes in Principle 10 and the communication issues in Principle 14 (Communicates Internally).

## Notes on Different Entity Types

- The scenario is equally applicable to all types of entities. However, management of a smaller entity would likely be more aware of any significant changes in its revenue processes and may address a lack of controls in a more timely manner.

## Overall Assessment of Internal Control Template

Assessment of Internal Control			
Entity or part of organization structure subject to the assessment (entity, division, operating unit, function)		Entity	
Objective(s) being considered for the scope of internal control being assessed		Considerations regarding management's acceptable level of risk	
Operations			
Reporting	External Financial Reporting	The acceptable level of risk for this assessment is based on materiality levels, determined to be 5% of profit before tax.	
Compliance			
		Present? (Y/N)	Functioning? (Y/N)
Control Environment		Y	Y
Risk Assessment		Y	Y
Control Activities		N	N
Information and Communication		N	N
Monitoring Activities		Y	Y
<b>Are all components operating together in an integrated manner?</b>  Evaluate if a combination of internal control deficiencies, when considered across components, represent a significant deficiency or material weakness.*  <Update Summary of Deficiencies Template as needed>		Because of the material weaknesses noted, the <i>Control Activities</i> and <i>Information and Communication</i> components are not present and functioning. Also, the two components are not operating together in an integrated manner. No other deficiencies or combination of deficiencies were noted that would be deemed a significant deficiency or material weaknesses.	
Is the overall system of internal control effective? <Y/N>*		N	
Basis for conclusion		Due to the material weaknesses noted in <i>Control Activities</i> and <i>Information and Communication</i> , these components were not present and functioning and the overall system of internal controls was not effective.	

\* If it is determined that there is a major deficiency, then management must conclude that the overall system of internal control is not effective.

## Component Evaluation Template—Control Activities

Component Evaluation—Control Activities				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
10. <b>Selects and Develops Control Activities</b> —The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.		N	N	A material weakness is noted in Principle 10. See deficiency details.
Identification No.	Internal control deficiency description	Evaluate internal control deficiency severity: (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
CA 10-1	There were inadequate control activities over the revenue process for Division C. An investigation of the root cause determined that control activities were not established at Division C because it was small and in a growth phase. During the course of the year, Division C grew to be a significant portion of the overall revenue, but controls were never implemented.	Material weakness	Due to the lack of control activities for one revenue stream, there is a reasonable possibility that a material weakness of the organization's financial statements would not be prevented, detected, or corrected on a timely basis.	Material weakness noted in Principle 14 (Communicates Internally—The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control)

Component Evaluation—Control Activities				
CA 10-2	As noted above, there was a failure to link the risk assessment with the establishment of controls at Division C, resulting in a lack of controls around revenue. While the process for scoping is generally sound, it needs to be more tightly linked to the risk assessment.	Material weakness	Due to the lack of control activities for one revenue stream, there is a reasonable possibility that a material weakness of the organization's financial statements would not be prevented, detected, or corrected on a timely basis.	Material weakness noted in Principle 14 (Communicates Internally—The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control)
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
11. <b>Selects and Develops General Controls over Technology</b> —The organization selects and develops general control activities over technology to support the achievement of objectives.		Y	Y	No deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
12. <b>Deploys through Policies and Procedures</b> —The organization deploys control activities through policies that establish what is expected and procedures that put the policies into action.		Y	N	No deficiencies noted.



Component Evaluation—Control Activities				
Identification No.	Internal control deficiency description	Evaluate internal control deficiency severity: (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Explanation/Conclusion		
<b>Evaluate deficiencies across the component:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a significant deficiency or material weakness.**		The deficiencies noted in Principle 10 represent material weaknesses. See comments in Principle 10 above. No other material weaknesses were noted.		
Evaluate the component using judgment and based on the principles and the deficiencies.**		Yes/No	Explanation/Conclusion	
Is the component present?		No	Due to the material weaknesses in Principle 10, the component was evaluated as not being present.	
Is the component functioning?		No	Due to the material weaknesses in Principle 10, the component was evaluated as not being present.	

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

## Principle Evaluation Template—Control Activities

Principle Evaluation—Control Activities		
Control Environment Principles	Summary of Controls	Deficiencies/Notes/Other Considerations (also record deficiencies in log below)
<b>10. Selects and Develops Control Activities—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.</b>		
Integrates with Risk Assessment—How do the control activities help ensure that risk responses that address and mitigate risks are carried out?	In general, control activities are established to address specific risks associated with the risk assessment. However, for Division C, inadequate revenue controls were in place.	Noted that there were inadequate control activities over the revenue process for Division C. Investigated the root cause and determined that the risk associated with this division had been noted because it was clearly in a growth phase and could eventually be material to the business.  There was a lack of coordination between the risk assessment process and Division C. As this division grew, controls should have been put in place to manage the risks identified in the risk assessment.
Determines Relevant Business Processes—How does management determine which relevant business processes require control activities?	An analysis of the company using the balance sheet, income statement, and risk assessment is used to determine which business processes require control activities. This analysis is updated annually.	Failed to link the risk assessment with the establishment of controls at the division. While the process for scoping is generally sound, it needs to be more tightly linked to the risk assessment.
Considers Entity-Specific Factors—How does management consider how the environment, complexity, nature, and scope of its operations, as well as the specific characteristics of its organization, affect the selection and development of control activities?	As part of the risk assessment process, the competitive environment, the state of the business, and the nuances of the organization are considered in determining and developing the specific control activities.	
Evaluates a Mix of Control Activity Types—How do the control activities include a range and variety of controls, and a balance of approaches to mitigate risks, considering both manual and automated controls, and preventive and detective controls?	Manual and automated controls as well as preventive and detective controls were considered. This is updated annually and factors in changes to systems and processes.	

Principle Evaluation—Control Activities						
Considers at What Level Activities Are Applied — How does management consider control activities at various levels in the entity?		An analysis of the entity in its entirety is reviewed and considers control activities at the entity level, as well as at the division and process-specific levels.				
Addresses Segregation of Duties—How does management segregate incompatible duties, and where such segregation is not practical how does management select and develop alternative control activities?		An analysis of sensitive access is performed, including a detailed segregation of duties matrix that defines potential segregation of duty conflicts. Wherever potential conflicts exist, access rights are aligned to segregate these duties. Where this is not possible, controls are developed to ensure that potential conflicting activities are logged and monitored.				
(Other entity specific points of focus, if any)						
Deficiencies Applicable to the Principle						
Identification No.	Internal control deficiency description	Possible Impact on Principle		Evaluate preliminary deficiency severity: (Consider whether other controls to effect this principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Present? (Y/N)	Functioning? (Y/N)	Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	
CA 10-1	There were inadequate control activities over the revenue process for Division C. We investigated the root cause and determined that control activities were not established at Division C because it was small and in a growth phase. During the course of the year, Division C grew to be a significant portion of the overall revenue, but controls were never implemented.	N	N	Material weakness	Due to the lack of control activities for one revenue stream, there is a reasonable possibility that a material misstatement of the organization's financial statements would not be prevented, detected, or corrected on a timely basis.	

Principle Evaluation—Control Activities					
CA 10-2	As noted above, there was a failure to link the risk assessment with the establishment of controls at Division C, resulting in a lack of controls around revenue. While the process for scoping is generally sound, it needs to be more tightly linked to the risk assessment.	N	N	Material weakness	Due to the lack of control activities for one revenue stream, there is a reasonable possibility that a material misstatement of the organization's financial statements would not be prevented, detected, or corrected on a timely basis.
<b>Evaluate deficiencies within the principle:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a significant deficiency or material weakness.** <Update Summary of Deficiencies Template as required>		See comments section above.			
Evaluate the principle using judgment		Y/N	Explanation/Conclusion		
Is the principle present?		N	Due to material weaknesses noted, the principle is not present.		
Is the principle functioning?		N	As the principle was not present, it is also not functioning.		

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

## 8. *Scenario D*: Are the Principles and Components Present and Functioning in a Division, Operating Unit, or Function?

### Purpose

- Illustrate how the Framework can be applied to a division, operating unit, or function.

### Company Background

- Midsized computer manufacturer and software retailer with an operating unit manufacturing and selling computers and associated equipment (operating unit A) and another operating unit selling and distributing third-party software (operating unit B).

### Objective

- The objective of the assessment is compliance to environmental laws for operating unit A.
- Management at operating unit A has a low-risk tolerance associated with achieving this objective.
- All evaluations in the templates are focused on the objective as it relates to operating unit A.

### Relevant Framework Reference(s)

- Because internal control is relevant both to the entity and its subunits, an effective system of internal control may relate to a specific part of the organizational structure.

### Facts and Circumstances

### Approach

- While the effectiveness of internal controls is assessed at the operating unit level, management may need to evaluate the components and principles at the “parent” level, the entity level in this scenario, since controls at the parent level can affect the system of internal control at the operating unit level.
  - Management will have to plan the evaluation of the seventeen principles at the relevant levels. Management may evaluate the principles at the operating unit level, the entity level, or at both levels.
  - In some cases, the operating unit level may be more relevant than the entity level, and in other cases the reverse may be true.

- This example illustrates management's approach to assessment of the effectiveness of internal control through the evaluation of the components and selected principles at relevant levels with respect to the declared objective at the operating unit A level.

## Evaluation

### Control Environment Component

- Management evaluated Principle 1 (The organization demonstrates a commitment to integrity and ethical values) at both the business and the entity levels since the policies, procedures, and actions at the entity level have at least some effect on operating unit.
  - The principle was found to be present and functioning at the operating unit level.
  - Internal control deficiencies were identified at the entity level.
  - Management determined that while the principle was present and functioning at the operating unit level, the internal control deficiencies at the entity level could jeopardize the objective of ensuring environmental compliance at this business in the longer term. A lack of commitment to integrity and ethical values at the entity level may over time cause the commitment at the operating unit level to deteriorate.
- Management evaluated Principle 2 (The board of directors demonstrates independence from management and exercises oversight for the development

and performance of internal control) at the entity level. Given the specificity of this principle to the board, this principle needs to be evaluated in the context of the entity's commitment as it relates to the objective at the operating unit level.

- The principle was found to be present and functioning at the entity level.
- Management evaluated Principle 5 (The organization holds individuals accountable for their internal control responsibilities in pursuit of their objectives) at the operating unit level. Management felt that it should evaluate the presence and functioning of the principle at the operating unit level as that was most relevant to the operating unit's objective.
  - The principle was found to be present and functioning at the operating unit level.
- The other two principles were found to be present and functioning.
- Evaluation of Control Environment component:
  - The five control environment principles were evaluated as being present and functioning at operating unit A. Management will need to determine whether the entity-level internal control deficiencies in Principle 1 are severe enough to preclude concluding that the component is present and functioning.

## Risk Assessment component

- Management evaluated Principle 6 (The organization identifies and assesses changes that could significantly impact the system of internal control) at the operating unit level only, as it felt that this was the most relevant level to evaluate the presence and functioning of the principle with respect to the objective.
  - The principle was found to be present and functioning at the operating unit level.
- The other three principles were found to be present and functioning.
- Evaluation of the Risk Assessment Component:
  - Management evaluated the four principles relating to the Risk Assessment component and concluded that the component was present and functioning.

## Control Activities component

- Management evaluated Principle 10 (The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels) at the operating unit level.
  - The principle was found to be present and functioning at the operating unit level.
- Management evaluated Principle 11 (The organization selects and develops general control activities over technology to support the achievement of objectives) at the central data center and determined that there was an internal control deficiency (not major) in the network level security control activities. However, the transaction level access control activities at the

operating unit were considered strong enough to compensate for these deficiencies.

- The principle was found to be present and functioning after considering compensating controls.
- The other principle was found to be present and functioning.
- Evaluation of the Control Activities component:
  - Management evaluated the three principles relating to the Control Activities component at the operating unit level and concluded that the component was present and functioning.

## Information and Communication component

- Management evaluated Principle 14 (The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control). Management evaluated this principle at both the operating unit and entity levels.
  - At the operating unit level, management determined the principle was present and functioning. However, at the entity level, management identified an internal control deficiency. Poor communication of internal control responsibilities at the entity level could impact the operating unit.
- The other two principles were found to be present and functioning.
- Evaluation of Information and Communication component.

- The three Information and Communication principles were evaluated as being present and functioning at the operating unit level. Management will need to determine whether the entity-level internal control deficiency in Principle 14 is severe enough to preclude concluding that the component is present and functioning. In making this determination, management may use the points of focus supporting the principles to determine if there are compensating controls either in this component or another component at the appropriate level (operating unit or entity level) that mitigates that risk that the deficiency identified could result in a failure of the stated objective.

### Monitoring Activities component

- Management has individually evaluated the two principles related to the Monitoring Activities component at the entity level and concluded that the component was present and functioning.

### Overall Assessment of Internal Control

- This template is not included for this scenario. The concepts related to completing an overall assessment template are illustrated in the Scenario, *Are the Five Components Present, Functioning and Operating Together?*.

## Summary of Key Points

- Some principles need to be evaluated at the entity level, some at the operating unit level, and some at both levels. Management needs to make this determination based on the objective and the way the company is organized.
- Internal control deficiencies noted at the entity level may or may not impact the evaluation of principles at another level, depending on the objective and the focus of the assessment.

## Notes on Different Entity Types

- The scenario is equally applicable to all types of entities. However, in a smaller entity or single location entity there likely will be less or no difference between the entity level and operating unit level controls.



## Component Evaluation Template

Component Evaluation—Control Environment				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
<b>1. Demonstrates Commitment to Integrity and Ethical Values</b> —The organization demonstrates a commitment to integrity and ethical values.		Y	Y	<p>This principle was evaluated at both the entity level and operating unit level.</p> <p>Determined that this principle was present and functioning at operating unit A, but noted an internal control deficiency (CE 1-1) at the entity level that could impact the objectives at the operating unit level in the long term. Since the objective of this review is focused on the operating unit, and adequate controls exist in the operating unit, it was determined that the principle was present and functioning despite the internal control deficiency.</p>
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
CE1-1	There is no requirement at the entity level to regularly confirm that personnel have read and understood the ethics policies.	N	Compensating control: All personnel at operating unit A are required to acknowledge that they have read and understand the ethics policies on an annual basis.	

Component Evaluation—Control Environment				
2. <b>Exercises Oversight Responsibility</b> —The board of directors demonstrates independence from management and exercises oversight for the development and performance of internal control.		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
		Y	Y	This principle was evaluated at the entity level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)  Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		
N/A				
3. <b>Establishes Structure, Authority, and Responsibility</b> —Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
		Y	Y	This principle was evaluated at both the entity level and operating unit level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)  Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		
N/A				

Component Evaluation—Control Environment				
4. <b>Demonstrates Commitment to Competence</b> —The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
		Y	Y	This principle was evaluated at both the entity level and operating unit level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
5. <b>Enforces Accountability</b> —The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
		Y	Y	This principle was evaluated at the operating unit level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				

## Component Evaluation—Control Environment

<p><b>Evaluate deficiencies across the component:*</b></p> <p>Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**</p>	Explanation/Conclusion	
Evaluate the component using judgment and based on the principles and the deficiencies.**	Yes/No	Explanation/Conclusion
Is the component present?	Yes	All principles are present despite internal control deficiency noted.
Is the component functioning?	Yes	All principles are functioning despite internal control deficiency noted.

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

## Component Evaluation Template—Risk Assessment

Component Evaluation—Risk Assessment				
6. <b>Specifies Suitable Objectives</b> —The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.		Present? (Y/N) Y	Functioning? (Y/N) Y	Explanation/Conclusion This principle was evaluated at the operating unit level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.) Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		
N/A				
7. <b>Identifies and Analyzes Risks</b> —The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.		Present? (Y/N) Y	Functioning? (Y/N) Y	Explanation/Conclusion This principle was evaluated at the operating unit level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description			Is internal control deficiency a major deficiency? (Y/N)
N/A				
8. <b>Assesses Fraud Risk</b> —The organization considers the potential for fraud in assessing risks to the achievement of objectives.		Present? (Y/N) Y	Functioning? (Y/N) Y	Explanation/Conclusion This principle was evaluated at the operating unit level.  No internal control deficiencies noted.

Component Evaluation—Risk Assessment				
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
9. <b>Identifies and Analyzes Significant Change</b> —The organization identifies and assesses changes that could significantly impact the system of internal control.		Y	Y	This principle was evaluated at the operating unit level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Explanation/Conclusion		
<b>Evaluate deficiencies across the component:*</b>  Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**		N/A		
Evaluate the component using judgment and based on the principles and the deficiencies.**		Yes/No	Explanation/Conclusion	
Is the component present?		Yes	No internal control deficiencies noted.	
Is the component functioning?		Yes	No internal control deficiencies noted.	

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

## Component Evaluation Template—Control Activities

Component Evaluation—Control Activities				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
10. <b>Selects and Develops Control Activities</b> —The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.		Y	Y	This principle was evaluated at the operating unit level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
11. <b>Selects and Develops General Controls over Technology</b> —The organization selects and develops general control activities over technology to support the achievement of objectives.		Y	Y	Evaluated this principle at the entity level (centralized data center) and operating unit level. We found an internal control deficiency related to network security control activities (CA-1) at the centralized data center. However, the transaction level security control activities at the operating unit effectively mitigate this internal control deficiency.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	

Component Evaluation—Control Activities				
CA1-1	There is no evidence of a periodic review of network access at the centralized data center.	N	Compensating control: Transaction level access control activities at the operating unit effectively mitigate this internal control deficiency.	
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
12. <b>Deploys through Policies and Procedures</b> —The organization deploys control activities through policies that establish what is expected and procedures that put the policies into action.		Y	Y	This principle was evaluated at both the entity level and operating unit level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Explanation/Conclusion		
<b>Evaluate deficiencies across the component:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**		Determined that the internal control deficiency noted in Principle 11 (CA-1 is effectively mitigated by the operating unit transaction level access controls. Consequently, determined that these internal control deficiencies do not represent a major deficiency.		
Evaluate the component using judgment and based on the principles and the deficiencies.**		Yes/No	Explanation/Conclusion	
Is the component present?		Yes	All principles present despite internal control deficiencies.	
Is the component functioning?		Yes	All principles functioning despite internal control deficiencies.	

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.



## Component Evaluation Template—Information and Communication

Component Evaluation—Information and Communication				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
13. <b>Uses Relevant Information</b> —The organization obtains or generates and uses relevant, quality information to support the functioning of other components of internal control.		Y	Y	This principle was evaluated at both the entity level and operating unit level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
14. <b>Communicates Internally</b> —The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control.		Y	Y	Evaluated this principle at the operating unit level and found no internal control deficiencies. However, noted an internal control deficiency (IC-1) at the entity level. Determined that there were compensating controls and did not preclude us from concluding that the principle was present and functioning at the operating unit level.

Component Evaluation—Information and Communication				
Identification No.	Internal control deficiency description	Evaluate internal control deficiency severity: (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
IC1-1	There is no regular communication at the entity level about responsibilities for internal control.	Internal control deficiency	Compensating control: Determined that responsibilities for internal control are established at the operating unit level.	
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
15. <b>Communicates Externally</b> —The organization communicates with external parties regarding matters affecting the functioning of other components of internal control.		Y	Y	This principle was evaluated at the entity level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description	Evaluate internal control deficiency severity: (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Explanation/Conclusion		
<b>Evaluate deficiencies across the component:*</b>  Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**		Determined that the entity-level internal control deficiency in Principle 14 (IC-1) is effectively mitigated by the operating unit controls. As such, determined that this did not represent a major deficiency.		

Component Evaluation—Information and Communication		
Evaluate the component using judgment and based on the principles and the deficiencies.**	Yes/No	Explanation/Conclusion
Is the component present?	Yes	All principles present despite internal control deficiency.
Is the component functioning?	Yes	All principles functioning despite internal control deficiency.

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

# Exposure Period Version

## Component Evaluation Template—Monitoring Activities

Component Evaluation—Monitoring Activities				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
16. <b>Conducts Ongoing and/or Separate Evaluations</b> —The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.		Y	Y	This principle was evaluated at the entity level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.) Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
17. <b>Evaluates and Communicates Deficiencies</b> —The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.		Y	Y	This principle was evaluated at the entity level.  No internal control deficiencies noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.) Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		
N/A				

Component Evaluation—Monitoring Activities		
	Explanation/Conclusion	
<b>Evaluate deficiencies across the component:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**	N/A	
Evaluate the component using judgment and based on the principles and the deficiencies.**	Yes/No	Explanation/Conclusion
Is the component present?	Yes	No internal control deficiencies noted.
Is the component functioning?	Yes	No internal control deficiencies noted.

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

## 9. *Scenario E*: How are the Assessments of Multiple Locations Combined?

### Purpose

- Illustrate how a large company doing an overall effectiveness assessment would roll up and combine assessments from multiple divisions.
- Illustrate that there are multiple ways to do an assessment depending on organizational structure.
- Illustrate that there is judgment involved in doing the overall effectiveness assessment depending on risk tolerance.

### Company Background

- Publicly held producer of paint and coatings with ten divisions.
- Headquartered in the Europe with manufacturing and retail locations in Europe and Latin America.
- \$7 billion in net sales; \$400 million net income.

### Objective

- Objective of assessment is operations—specifically ensuring that internal controls around quality are effective.
- Company has a low risk appetite and tolerance for quality issues.

### Relevant Framework Reference(s)

- An effective system of internal control provides reasonable assurance regarding achievement of an entity's objectives. Because internal control is relevant both to the entity and its subunits, an effective system of internal control may relate to a specific part of the organizational structure. An effective system of internal control reduces, to an acceptable level, the risk of not achieving an objective relating to one, two, or all three categories. It requires that:
  - Each of the five components of internal control and relevant principles are present and functioning
  - The five components are operating together in an integrated manner
- *Risk appetite* is the broad-based amount of risk an entity is willing to accept in pursuit of its mission/vision. It serves as a guidepost in strategy-setting and selecting related objectives.

- *Risk tolerance* is the acceptable level of variation in performance relative to the achievement of objectives. In setting risk tolerance levels, management considers the relative importance of the related objectives and aligns risk tolerance with risk appetite.
- Operating within risk tolerance provides management greater assurance that the entity remains within its risk appetite, which in turn provides added comfort that the entity will achieve its objectives. The concept of risk tolerance is included in the Framework, as a pre-condition to internal control, but not as a part of internal control.

## Facts and Circumstances

- There are multiple ways to approach this assessment, e.g. (but not limited to):
  - Evaluate each component across the entire company.
  - Evaluate all components for each division and roll them up.
  - Evaluate all components for each major geography and roll them up.
- There is no one right way to do this; it depends on the way the organization is set up. In this scenario, processes and controls are similar across geographies, but differ between divisions as the company is decentralized and each division acts like its own company. Because of this decentralization, management determines that the most logical approach is to evaluate all the components for each division and roll them up to do an overall assessment at the entity level. The scenario illustrates how this rollup occurs for each division in the component summary template, an overall component conclusion, and a list of the deficiencies.
- For this example, management finds that Division 4 has a major deficiency within the Risk Assessment component and determines that this component is not present and functioning for that division.
  - The major deficiency occurs because despite this division having a risk assessment process, it does not have a process to analyze those risks to determine how they should be managed. Management is concerned that some of the risks identified related to the quality of vendor-supplied raw materials could adversely affect the quality of the end-product.
  - It is determined that the major deficiency is isolated to this division.
  - Note that in this example, the major deficiency is only “major” as it relates to this divisional analysis.
- The scenario illustrates that there is judgment involved in how an internal control deficiency at a division would need to be considered at the overall entity level.
  - The affected division is relatively small, making up only 15% of overall product sales (by number of units) for the company. However, because of the company’s low risk tolerance, management needs to determine if the overall Risk Assessment

component is present and functioning despite the small size of the division.

- Management needs to determine if the overall assessment of internal controls related to the operations objective is effective given the major deficiency noted at the division level, the relative size of the division, and the overall company's risk tolerance.

## Summary of Key Points

- A major deficiency noted at the division level (or any level below the level at which controls are being evaluated) needs to be evaluated in the context of the entity to determine if a major deficiency exists at the level at which internal controls are being assessed.
- Internal control deficiencies need to be evaluated in the context of the stated objective and the company's risk tolerance when consolidated at the entity level.
- Management may choose to customize the templates to suit their specific needs depending on the organization and objective.

## Notes on Different Entity Types

- The process to combine multiple assessments is likely to be simpler when a less complex organizational structure exists.

Exposure Period Version



## Overall Assessment of Internal Control Template

Assessment of Internal Control				
Entity or part of organization structure subject to the assessment (entity, division, operating unit, function)		Entity		
Objective(s) being considered for the scope of internal control being assessed		Considerations regarding management's acceptable level of risk		
Operations	Objective is effectiveness of quality controls.	Management considers quality to be extremely important and has a very low risk tolerance for quality issues.		
Reporting				
Compliance				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
Control Environment		Y	Y	[Author's note: Management needs to determine if the major deficiency at the division level precludes it from concluding that the component is present and functioning at the organizational level.]
Risk Assessment				
Control Activities		Y	Y	
Information and Communication		Y	Y	
Monitoring Activities		Y	Y	
<b>Are all components operating together in an integrated manner?</b> Evaluate if a combination of internal control deficiencies, when considered across components, represent a major deficiency.* <Update Summary of Deficiencies Template as needed>		[Author's note: Management needs to evaluate whether the major deficiency at the division level is still considered major at the organization level. Some factors to consider include the size of the division (15% of overall product sales) and the risk tolerance of the company as it relates to this objective (low). In addition, management needs to determine if the components are operating together in an integrated manner.]		
Is the overall system of internal control effective? <Y/N>*		[Author's note: Management needs to determine if the overall assessment of internal controls related to the operations objective is effective given the major deficiency noted at the division level, the relative size of the division, and the overall company's risk tolerance.]		
Basis for conclusion		See notes above.		

\* If it is determined that there is a major deficiency, then management must conclude that the overall system of internal control is not effective

## Customized Table to Evaluate Risk Assessment Component Across Divisions

	Division 1	Division 2	Division 3	Division 4	Division 5	Division 6	Division 7	Division 8	Division 9	Division 10
Principle 6	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies
Principle 7	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	Major deficiency noted	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies
Principle 8	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies
Principle 9	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies	P/F with no deficiencies

## Component Evaluation Template—Risk Assessment

Component Evaluation—Risk Assessment				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
6. <b>Specifies Suitable Objectives</b> —The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.		Y	Y	This principle was evaluated at each division and no internal control deficiencies were noted.
Identification No.	Internal control deficiency description	<b>Evaluate internal control deficiency severity:</b> (Consider whether the controls to effect another principle compensate for the internal control deficiency.)  Is internal control deficiency a major deficiency? (Y/N)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Comments/Compensating Controls		
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
7. <b>Identifies and Analyzes Risks</b> —The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.				This principle was evaluated at each division and an internal control deficiency (RA1-1) was noted at Division 4 related to the fact that there is no process to analyze risks to determine how they should be managed.  <i>[Author's note: Management needs to determine whether this internal control deficiency in a single division is severe enough to conclude that the principle is not present and functioning for the entire organization.]</i>

Component Evaluation—Risk Assessment				
Identification No.	Internal control deficiency description	Evaluate internal control deficiency severity: (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
RA1-1	For Division 4, management noted that although there is a risk assessment process in place, there is no process to analyze the identified risks to determine how they should be managed.	Y	The major deficiency is at the division level.	
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
8. <b>Assesses Fraud Risk</b> —The organization considers the potential for fraud in assessing risks to the achievement of objectives.		Y	Y	This principle was evaluated at each division and no internal control deficiencies were noted.
Identification No.	Internal control deficiency description	Evaluate internal control deficiency severity: (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
9. <b>Identifies and Analyzes Significant Change</b> —The organization identifies and assesses changes that could significantly impact the system of internal control.		Y	Y	This principle was evaluated at each division and no internal control deficiencies were noted.

Component Evaluation—Risk Assessment				
Identification No.	Internal control deficiency description	Evaluate internal control deficiency severity: (Consider whether the controls to effect another principle compensate for the internal control deficiency.)		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Is internal control deficiency a major deficiency? (Y/N)	Comments/Compensating Controls	
N/A				
		Explanation/Conclusion		
<b>Evaluate deficiencies across the component:*</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered across the component, represent a major deficiency.**		<i>[Author's note: Management needs to evaluate whether the major deficiency at the division level is still considered major at the organization level. Some factors to consider include the size of the division (15% of overall product sales) and the risk tolerance of the company as it relates to this objective (low).]</i>		
Evaluate the component using judgment and based on the principles and the deficiencies.**		Yes/No	Explanation/Conclusion	
Is the component present?			<i>[Author's note: Management needs to determine if the major deficiency at the division level precludes a conclusion that the component is present at the organization level.]</i>	
Is the component functioning?			<i>[Author's note: Management needs to determine if the major deficiency at the division level precludes a conclusion that the component is functioning at the organization level.]</i>	

\* Note: Record deficiencies in Summary of Deficiencies Template.

\*\* If it is determined that there is a major deficiency, then management must conclude that the component is not present and functioning and the overall system of internal control is not effective.

